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ADLER POLLOCK & SHEEHAN P.C.

Mergers & Acquisitions Glossary

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Introduction - This Glossary contains many of the important terms and definitions used in the M&A world. The Glossary is not exhaustive, however. Like most areas of the law, M&A is a highly complex subject that involves several legal and non-legal disciplines [e.g., accounting, business] as well state, and often, federal law requirements. To cover everything we would need a Dictionary. Rather, the Glossary focuses on the important terms and definitions which the students will need along with the course materials and instruction to attain a foundational understanding of the M&A process and related law. In one semester we cannot expect students to become experts in this area. Indeed, it is only when lawyers actually practice M&A law that they can fully understand how the "theory" fits with reality and how this all works, despite the efforts we will make in this course to infuse "real world" M&A materials and problem solving exercises. Having said this, if law students can grasp the fundamental propositions and legal principles that encompass this field of practice, their transition to it as lawyers will be quicker and more productive for themselves and their clients. Equally important, it is impossible to think like an M&A lawyer, let alone speak like one, unless students are reasonably conversant with the terms and definitions we will encounter in this course. I am constantly struck by many students who resist using the term merger or successor liability, for example, after the first few weeks of the course, when the term is clearly called for and the context is relatively simple. Whether it is because they are not comfortable with a term, or don't fully understand it is difficult to tell. Maybe they haven't bothered with the Glossary given their heavy workloads and text assignments. In any event, the Glossary is available and it's ultimately up to the individual student to decide whether to use it or not.

As we move through the course, feel free to supplement the Glossary with new terms and definitions or modify and even correct those contained here. Please don't be shy about informing me if you disagree with anything contained in this document or find any typos. I am far from the last word on the subject of Mergers & Acquisitions. A day doesn't go by that I don't learn something new in this area; or occasionally, unlearn something.

One final comment. this Glossary differs from most similar devices with respect to the narrative sections under the terms and definitions. For many of the terms, I have attempted to flesh out the definitions with examples and extended discussion that are tied to many of the fundamental principles that will be encountered in the course. Generally, a term is briefly defined, followed by discussion or analysis which allows the students the option of focusing solely on the term, or for the more ambitious, obtaining an additional perspective on how the term fits in the overall subject matter of the course. In other words, the Glossary is an additional learning tool. This is not a license to ignore the syllabus, course materials and class room discussion, however. It is relatively easy for the professor to figure out whether a student actually understands a term or is just regurgitating the Glossary. More important, the Glossary alone will not be of much practical benefit. Applying the terms to the course materials and problems, articulating them in class room discussions, on exams and on take home assignments, is where the value comes from.

Scenario [Problem 1-Classes I and II]

Before you go dive into the Glossary, below is a somewhat simplistic M&A scenario which in practice would entail many of the terms, processes and fundamental principles we will be learning about.

Company A, a large public company, makes business jets. It's incorporated in Delaware. Its revenues are currently $3B for the prior year with a 9% profit margin, which isn't all that great. For the last few years its revenues have been flat. Its shares are currently trading at $19 per share on the New York Stock Exchange, and the company has a sizeable debt load. The company has 20,000 employees located between the corporate headquarters and five plants in three states and several service centers worldwide. The company has 40% of the market for the sale of business jets worldwide. Its closest competitor has a 30% market share, which is a term antitrust regulators aren't enamored with. One of the primary impediments to Company A's sales is the cost to operate the jets; the heavier the jets, the more jet fuel that is used, and thus, the greater the cost to operate the jets. The business jet market is very competitive because the industry basically has the same manufacturing cost structure, uses the same materials to build the jets, etc. In other words, Company A and its competitors basically differentiate themselves on such things as after-market sales [e.g. service and spare parts] and interior design. All things being equal, the company that can reduce significantly the operating cost of its business jets will sell more jets and thus achieve greater revenues and profits, the *sine qua non* of most companies, surely ones with public shareholders.

Company B is a relatively small publicly held materials manufacturing company incorporated in Delaware. It has 2,000 employees located in a series of facilities including a headquarters building in an industrial park. Company B recently obtained a patent for composite airframe materials, which would significantly lighten the weight of business jets. Its shares are trading at $10 on the New York Stock Exchange, which is up 20% with the news of the patent. Its annual revenues have been flat for the last five years. Company A's competitors are not convinced that this new material will be safe, let alone be approved for use on business jets by the Federal Aviation Administration [FAA], so they are willing to sit tight to see what else develops with the technology, including their own research and development efforts in this area. Company A has spent millions on composites over the years and believes that it understands the technology infinitely better than its competitors and also believes that Company B's airframe material is safe and will be approved by the FAA.

Company A's CEO convinces his board of directors that the company should spend up to $500M to acquire Company B. This is a lot of money, considering that Company A probably will have to raise over 50% of this amount through a debt offering [e.g., corporate bonds] which will only add to its already heavy debt load. The company could use its own stock as consideration, however, which has certain advantages. The CEO's reasoning for the acquisition is that the new material will result in significantly increased sales [revenues] which will generate significant profits through synergies and in turn lead to a higher share price. He sends a letter to Company B's CEO suggesting a friendly business combination.

Company A and Company B [whether it wants to or not]; their boards; senior management [Officers], shareholders; employees; federal and state regulators; many more stakeholders, including the lawyers-you some day-; and even the courts, depending on what transpires in Company A's quest for Company B, have just entered the world of M&A. Actually from the time Company A's CEO learned of Company B's patent the M&A process probably began, if not sooner

Ultimately, Company A acquires 100% of Company B's stock for $15 per share and successfully integrates the latter into its operations. In other words, Company B ceases to exist as a legal entity. [Q: Is this a merger? Acquisition? Both?] For all intents and purposes, the formal M&A process has concluded for this particular transaction. The informal part would be integration of the two businesses and dealing with any post closing liabilities arising from Company B's business which now belong to Company A by virtue of the merger. Of course, the success of the acquisition—did it achieve the CEO's objectives, especially achieving growth for his company, is dependent on a number of factors, including whether the material actually works and whether the FAA certifies the material for use in the manufacture of business jets. [Q's: What if Company B's key engineers who best understand the process for manufacturing the material decide not to join Company A? What happens if the worldwide market for business jets drops significantly, as it did starting in September of 2008? What if a patent infringement lawsuit concerning the composite material is filed and the plaintiff wins? What if a competitor develops even lighter materials which achieve greater fuel efficiency?]

As the foregoing discussion reveals, there are many variables to a successful transaction. Perhaps this is why the failure rate for acquisitions, at least for public companies, is high. There is a lot of risk in these transactions and miscalculations along the way, especially on the bidder's part, which can lead to very bad outcomes if not properly managed.

As you read the Glossary, try to fit the definitions and terms into this scenario as best you can. Ask yourself, why Company A wanted to do this deal? Who is the buyer or bidder? Who is the target or seller? What structure (form) was used for the transaction? Well, we already know it was a merger but why did Company A select this option? What advantages might it have over one of the other two basic structures? What was Company A's CEO's economic value proposition? What is an economic value proposition anyway, and why is it important? What do you think the "client's objectives" were for Company A's CEO? Company B's? What process did Company A employ to understand actually what it was acquiring? What was Company B's role in this process? What corporation law applies to this transaction? Does the state of incorporation of each company govern the transaction? Any federal laws which the transaction might trigger? How about any requirements of the New York Stock Exchange which both companies trade on? Why would Company B's board even consider being purchased? Is it even the board's decision? Don't the shareholders get to approve the transaction? What devices could Company B's board use to resist being purchased if Company A's bid turns hostile, that is, they pursued a hostile takeover? Does B's board have unlimited authority to resist <u>any</u> hostile takeover? Which internal stakeholders had to approve the transaction for each company? Where would you look to find the answer to this question? What role did the respective boards play here in terms of approval? Did any of the companies undergo fundamental change? Why is the answer to this question important? What if some of Company B's shareholders were unhappy with the $15 share price? Are they stuck with it as long as a majority approved the transaction? What remedies might they have? What are appraisal rights? Breach of fiduciary duty claims? What would they have to show or prove to be successful under either theory?

What do think Company A's board was concerned with? Company B's board? What other forms of business combinations or arrangements might the parties have explored? I already mentioned two. What if Company B's board resisted Company A's overtures? Could it have, especially if Company A was paying a premium price over what the stock was trading for at the time? What routes might Company A take to get the company, if Company B's board resisted the merger? What do you think the process was for getting from the "friendly offer" to the closing phase and beyond, and where did the lawyers fit in this process? The transaction is memorialized in what document? What is the M&A process or timeline anyway? Who are the key internal and external stakeholders-that is, those persons, organizations and governmental entities which influenced the transaction from beginning to end? Any regulatory hurdles to get over? Finally, the statistics on failed mergers are pretty dreadful. What could cause this deal to turn out badly for Company A? If you were on the board of Company A, would you have approved this transaction? If you were a shareholder of Company A and the deal went bad, would you have a viable basis for a lawsuit? Who would you sue if you did? What kind of buyer was Company A? What kind of growth did the acquiring of Company B represent? Would synergies apply here? How did Company A go about valuing Company B for purchase price purposes? Did the federal securities laws come into play for this transaction?

Terms and Definitions

Acquiror - The company or person who acquires another company or some or all of its assets through an **acquisition**. The key here is that the acquiror obtains control over the acquired company or assets. Other words for aquiror which are often used: **buyer** or **bidder.** The company which is acquired or sells some of its assets [or 100% of itself for that matter] to the buyer is the **seller** or **target** company, the later term being more apt within the context of a hostile takeover or merger. While we are at it, in the M&A world there are two basic types of acquirors: **strategic buyers** and **financial buyers**. A strategic buyer generally seeks to purchase a company or its assets because it will benefit [i.e., increase growth which generally means profits] its underlying business. In other words, the strategic buyer intends to run the new business for the long haul either separately or part of its larger business with the objective of improving its company's growth [e.g. profitability]. Strategic buyers often are able to obtain significant **Synergies** with the acquisition, which can allow them to pay more for the acquired company or assets. Companies such as GE, United Technologies and Textron Inc. are generally strategic buyers when they engage in M&A transactions. A financial buyer [e.g., private equity firms such as KKR] generally looks to buy the company, restructure or otherwise improve the acquired company and then "flip" it by going public [IPO], if the company was taken private or selling it to another company, all at a nice return on its investment [price it paid which is generally equity + extensive financing of some sort]. Generally, a return of 20% to 30% on the initial investment is considered an acceptable Initial Return on Investment [IRR]. Occasionally, a financial buyer will acquire a company with the intention of immediately selling off all or part of it, because it believes the price it will receive for the parts is a good investment. See **Bust-Up** below. One of the advantages financial buyers have over strategic buyers is that they generally have greater access to relatively inexpensive financing to support the purchase price. In short, strategic buyers tend to think long-term operation of the acquired company or assets, whereas financial buyers tend to think shorter-term operation as a prelude for a sale or public offering to get an acceptable IRR. However, both types of buyers have the same end game: achieve an acceptable return on their investment ["ROI"] from the acquired company or assets. Summing all this up, M&A is an aspect of corporate business strategy because it can lead to growth for the acquiror. And growth, no matter how it is achieved, is the predominate goal of most businesses.

Accretion- In the M&A context, an important term that goes to the rationale for an acquisition: the growth in the **Acquiror's** assets as a result of the **Acquisition**. Of course, if the acquisition results in liabilities that exceed the acquiror's projections, the growth in assets may not be sufficient to achieve the acquiror's **Economic Value Proposition** which means that the deal is a failure.

Acquisition - All encompassing term which refers to a company or person acquiring a controlling interest or ownership of another company entirely, or some of its assets [e.g., a division, product line]. Mergers are often referred to as acquisitions, although one of the two parties generally ceases to exist as a legal entity. A **Divestiture** is the opposite of an acquisition. For example, Company A buys a division from Company B. A acquires the division through an acquisition; B's sale of the division is a divestiture. The term M&A includes divestitures. For accounting purposes, a divesture is considered to be a discontinued operation and any residual liabilities or costs associated with it are treated separately on the income statement. An acquisition is a "business combination," but strictly speaking, so is a joint venture or partnership. However, the latter are generally not considered to be acquisitions for M&A purposes, but rather "strategic" or "business" alliances.

Acquisitions including mergers generally do not occur over-night. They often take considerable planning, time and cost to completion. See **M&A Process/Timeline**. Moreover, M&A entails a multi-disciplinary approach including operations, strategy, finance, legal, accounting, human resources, environmental, risk management, and insurance as well as other disciplines. Stated another way, M&A transactions can be complex, costly, and lengthy undertakings fraught with risk and potential miscalculation. There are three basic forms of acquisitions or **Structures**: (1) asset, (2) stock purchase, and (3) merger. Each form has its advantages and disadvantages for bidders and targets relative to their objectives, which only adds to the level of complexity.

Important note: Every M&A transaction should be looked at as involving at least two parties—the buyer/bidder and the seller/target, and frequently a third, the government in some shape or form.

Acquisition Vehicle - Legal entity such as a shell company or other subsidiary corporation set up to the effect the transaction. See e.g., **Triangular Merger**. Acquisition vehicles can achieve several important advantages such as insulating the parent from the subsidiary's liabilities, facilitating a going public transaction, and tax savings. TFS Acquisition Inc., which comes up in the transaction discussed in Class 7, is an example of an acquisition vehicle.

Advantages and Disadvantages- All M&A transactions [i.e., offerings] are not equal in terms of achieving the **Client's Objectives**. Stated another way, each transaction has certain advantages and disadvantages relative to what the client wishes to achieve. A major part of the deal lawyer's role is to understand the potential transactions, or **Structures** to be more precise, well enough to assist the client with selecting, structuring and completing a transaction which best meets its need. For example, a **Tender Offer** generally has the advantage of speed over most negotiated mergers. All things being equal, if speed is your client's most important objective [next to price, of course, which is almost always the primary objective] then a tender offer is superior. If your client is concerned that it will be acquiring too many liabilities in a transaction, an asset deal may be preferable to a merger. It is infinitely more complex than this, but you should get the picture: the deal lawyer cannot do his or her job unless he or she fully understands the ins and outs of a transaction, especially the structure.

All-holders Rule - Whether a **Tender Offer** for the target company's shares, or a **self-tender**, this rule requires, with minor exception, that the tender for any class of shares be made on the same terms to all shareholders by class. In other words, the company making the tender offer for the shares of another company may not offer one price for one segment of the common shareholders and another price for the other part [e.g., minority shareholders]

Alternate Dispute Resolution [ADR] - Generally, non-judicial proceedings [arbitration before the American Arbitration Association being the classic example] for resolving disputes arising, *inter alia*, from **Definitive Agreements** in the M&A context. The thought behind ADR is that it greatly reduces the unpredictability, time, costs and expenses associated with litigation in the courts. Confidentiality and limited damages [e.g., no punitive damages] also may be important considerations and there are others. Arbitration is not the only form of ADR, just the one most frequently used relative to M&A transactions other than purchase price adjustment disputes. Interestingly, arbitration, especially international arbitration, can be quite expensive and can result in judgment enforcement problems as well as other problems. Nothing is perfect. A frequent variation on the arbitration theme in asset transactions is agreeing on a neutral accounting firm to decide tax and accounting related disputes because of their technical nature. **See e.g., Purchase Price Adjustments**. In any event, arbitration is designed to be final, absent highly unusual situations; thus, care must be taken to assess whether your client would be better off in arbitration than in some country's court system or a federal or state court in the U.S. Equally important, the arbitration clause must be drafted carefully to be effective, which is why it is not recommended that it be addressed at the last minute by the parties if is considered important. When one of the parties to a transaction is a non-U.S. company, the parties often will agree on arbitration before an international arbitral body such as the International Chamber of Commerce ("ICC"), which can be a very expensive proposition.

Antidilution Provision - Complex term which basically means that certain holders of securities [e.g., preferred shares, convertible debentures] are protected from their shares losing value, if a particular transaction will cause a change in the common shares thus diluting the value of their securities.

Anti-fraud Rules - The principal means of enforcing through government or private proceedings or both, federal and state securities laws. Rule 10b-5 promulgated under section 10(b) of the Securities Exchange Act of 1934 is the most important federal antifraud provision.

In broad terms it prohibits fraudulent and manipulative acts in connection with buying or selling securities, including disclosure and accounting fraud, and trading on inside information. If a security is involved in any M&A transaction [e.g. all or part of the purchase price], everyone involved pays attention to not violating the anti-fraud rules not to mention applicable federal securities laws, or at least they should. A merger of two public companies by definition involves a security. Ditto for a public company going private. An asset transaction, however, does not generally involve the sale of securities and thus 10b-5 is one less thing to worry about. However, some states, such as California, take a different view. In any event, even if a section 10 (b) federal fraud action is not applicable, this does not mean that common law fraud cannot be the basis for a legal proceeding relative to an M&A transaction. Indeed, depending upon the circumstances both may be alleged. See the Landreth case discussed in the text for a basic example of how an acquisition of a private company can trigger the anti-fraud provisions, but not other regulatory sections of the securities laws [e.g., Section 5 registration requirements under the Securities Act of 1933].

Anti-Sandbagging Provision - A provision in a **Definitive Agreement** requiring the acquiror to inform the seller of any representation or warranty, which it learns is incorrect prior to closing, to allow the seller the opportunity to cure the problem. Violations of the anti-sandbagging proposition can result in a party losing its right to sue on a representation and warranty, either as a basis to not close or indemnification after the deal closes.

Antitakeover Laws - State statutes designed to make takeovers difficult, if not almost impossible in some cases, although if literally impossible the statutes would be unconstitutional. See DGCL Section 203 for Delaware's antitakeover statute, which is surprisingly onerous. Other states are even more protective of their corporations. Arizona, for example, is especially hostile to takeovers. Today, approximately 92% of all U.S. corporations are covered by antitakeover statutes. Similar to the **Williams Act**, Delaware's antitakeover statute ostensibly was enacted to protect **shareholders** from being stampeded into tender offers by giving them more notice and time to consider their options. Intended or otherwise, both have the additional consequence of affording target boards the opportunity to consider or enact defensive measures in the wake of a hostile takeover. As we shall see, however, the antitakeover statutes are not insurmountable, especially when the bidder offers a substantial premium for the target's shares that represents a fair and adequate price to pay for the business.

Antitrust Division - The Antitrust Division of the Department of Justice is one of the two Federal agencies that enforce the federal **Antitrust Laws**. The other is the Federal Trade Commission [FTC]. Antitrust considerations can be an important factor in M&A transactions depending on the size of the person or transaction and especially, if the acquiror and target are in the same or closely related industries [e.g., **Horizontal Merger]**. A good example is the merger a few years ago between the Sirius and XM satellite radio companies. Those opposed to the merger were concerned that the combined companies would have such a dominant market share that they would be able to artificially set the price of access. Those in favor of the merger argued that the relevant entertainment market was not only satellite radio, but included consumers of "terrestrial" or FCC regulated radio, TV, the Internet, etc. which the new company would not dominate. Although ultimately the FTC did not oppose the transaction from an antitrust perspective, legions of lawyers and lots of money were spent by Sirius and XM convincing the FTC of the correctness of their position. Some think that the real motive behind the opposition to the merger was that satellite radio is unregulated and people like Howard Stern, who has had numerous run ins with the FCC, would now have unregulated outlets to spew obscenities and other forms of less desirable speech. Its motive; not necessarily mine. Howard Stern is an acquired taste, for sure. Interestingly, the government "approval" [clearance] did not prevent an antitrust class action against Sirius which settled in 2011 for freezing the subscription rates for a period of time and a $13M payment to the class lawyers. Again proving that in most class action litigation, the lawyers are the only winners.

Occasionally other federal government agencies will get to weigh in on business combinations in addition to DOJ/FTC. For example, the Federal Communications Commission applies the "best interests of the consumer" test for approving combinations in the telecommunications industry, which Clear Channel recently ran into in its failed attempt to purchase Time-Warner. The banking industry, which is even more highly regulated, offers an even more complex antitrust review process. Depending on the nature of the banks engaged in a business combination, one of three federal agencies [Federal Reserve Bank, Office of the Comptroller General and Federal Insurance Deposit Corporation] has approval authority with the analysis and advice of DOJ and State Attorney General. Unfortunately, we don't have enough time to spend on business combinations in the banking sector, although many of the fundamental propositions and legal principles discussed in this course apply to such transactions.

Antitrust considerations include among other considerations: 1) whether notice of the transaction is required under **Hart-Scott-Rodino**; 2) whether the transaction will be cleared by the federal government; 3) whether during the transaction itself antitrust issues will arise and 4) how to factor the risk of antitrust clearance and related matters in the negotiations and ultimately the **Definitive Agreement**. Thus, antitrust can be an important consideration in a M&A transaction which requires early planning on the part of the deal lawyer.

Antitrust Laws [Federal] - For purposes of this course, we will be referring to the Sherman [most importantly, section 7] and Clayton antitrust acts which prohibit certain business practices including combinations which create an unfair [that is, restrictive or non-competitive] market place [e.g. price fixing, monopolies]. In other words, actions which adversely affect competition in a particular market. Penalties for violating the antitrust laws can be severe, including criminal penalties for companies and individuals. As previously discussed, antitrust issues can play an important role in structuring and completing an M&A transaction. See also **DOJ Antitrust Division** and **Hart-Scott-Rodino Act.** State antitrust statutes may occasionally come into play as well as international regimes such as European Union antitrust law for cross-border transactions. It should be apparent by now that if a transaction has the potential to trigger **H-S-R** filings and government review, which can lead to opposition to the business combination, the deal lawyer needs to address these issues early in the transaction.

Appraisal Rights - Very important remedy for those shareholders who don't believe that they are getting a fair price for their shares when their company is sold. And not to be confused with a claim for damages based on a breach of fiduciary duty which generally extends to all the shareholders. Basically, the relevant state statutes [not all have this] afford the dissenting shareholders the right to challenge the share price in court. You will have to read **DGCL** §262 very carefully to determine the limitations on the availability of appraisal rights in merger transactions, especially the so-called "Market Out" exception. See DGCL §262(b). Ah, but to make things even more confusing, there is an exception to the Market-Out exception. See DGCL §262(b)(2). As we will see when we discuss the Delaware case law on this subject, the "formula" for determining what a fair price or "value" is can be mind numbingly complex. Recent statistics reveal that in the majority of appraisal lawsuits the dissenting shareholders do better than those who agreed to the sale price. Many states do not afford dissenting shareholders appraisal rights in asset transactions. See, e.g., DGCL Sec 271. California, however, appears to allow for such rights in certain asset transactions. Also, by definition appraisal rights do not apply to public stock transactions such as tender offers and cash out mergers, because the shareholder is free to sell or not sell their shares. Even if available, appraisal rights are not automatic. Under the Delaware statute, for example, dissenting shareholders must take several steps before their appraisal rights are "perfected," otherwise they will lose the right. One final point, recently appraisal rights have become an investment strategy for certain institutional investors which Delaware is attempting to deter by, <u>inter alia</u>, reducing the interest rate for such actions to make them less attractive.

Approval - Important concept in M&A law which comes under the heading of **Corporate Formalities** for state corporation law purposes. Depending on the structure of the transaction, board and shareholder's approval may be required. For example, a standard forward statutory merger involving totally separate companies generally requires both approvals. Depending on the nature and size of the asset purchase, neither approval may be required. In other words, management [Officers] may have the authority to do the deal without board approval, generally through a **Delegation of Authority** process. Once we get to the governmental side of a transaction, the term "approval" is something of a misnomer. For example, the government does not approve transactions under the antitrust rules; it "clears" them. The SEC does not approve registration statements if required for the issuance of stock as part of the purchase price; it orders the registration statement "effective." In short, this allows the government or private parties to challenge transactions on legal grounds later on, although the government is wary about such challenges unless the underlying facts and circumstances have changed.

For corporate formality purposes, the starting place for determining whose approval is required for a particular transaction is the state corporation statutes, but don't forget about the articles of incorporation [certificate of incorporation in Delaware] and by-laws which may supplement or exceed the statutory requirements [e.g., Super-Majority].

Assets- What a company owns that are of tangible value [e.g., inventory, plants, equipment] or intangible value [e.g., accounts receivables, intellectual property, insurance policies]. The opposite of liabilities, current or contingent, which are financial obligations of the company such as loans, accounts payable and lawsuits. Obviously, two important categories of information that an acquiror will need to understand before it closes a transaction. One of the purposes of **Due Diligence** is to confirm what the bidder or buyer is actually purchasing. Hard to do without understanding the important assets and liabilities of the target or seller, although not every M&A transaction entails due diligence. For example, as a general proposition, hostile takeovers do not have a formal due diligence phase. For "main street" transactions, analyzing assets and liabilities is critical. Net assets refer to a company's total assets minus its total liabilities, not to be confused with the market value of the company's shares. In any event, net assets can be an important consideration for M&A purposes.

Asset Acquisition - The acquisition of the target [seller] company's assets [including a product line] up to and including 100% of the company, which often sees the buyer assuming some of the liabilities of the target company generally by agreement, but occasionally by law. *Contra* merger where by operation of law, the buyer assumes all the rights and liabilities of the target, with minor exception. A major advantage of an asset transaction is that it allows the buyer to pick and choose what's valuable, and avoid what is not, as well as unwanted liabilities and obligations. A critical issue in many asset deals is whether the acquiror by contract or law has assumed the liabilities and obligations of the seller it has chosen not to assume. See **Successor Liability**. As we will keep coming back to in this course, asset transactions like merger and stock purchase transactions have advantages and disadvantages relative to the **Client's Objectives.**

Auction - A device where the board of directors, often through a **Special Committee** of the board, offers the company for sale hoping that it will attract multiple bidders which will result in a maximum sale price. As such, the board's **Revlon Duty** is triggered. Under Revlon, the board is required not only to get a fair price [fairly reflects the company's value] but the best reasonably attainable price. Assume there are two bidders in an auction of a company. A bids $33 a share [which is a fair price] and B bids $35 a share [which is a fair price by definition because if $33 is, then $35 is as well], but $35 is obviously a better price for the shareholders. Assuming that in all other material respects each bid is the same but for the price, and there are no other mitigating factors such as the presence of a **Constituency Statute** or the equivalent provision in the articles of incorporation to complicate matters, under Revlon the board is compelled to take the $35 bid otherwise it is in breach of its fiduciary duties. For large transactions, an **Investment Banker** often will be retained to advise the board on the conduct of the auction, including issuing a **Fairness Opinion** concerning the negotiated price for the transaction. In this respect, consider fairness opinions to be at least a "belt and suspenders" to support the board's decision in this regard.

Basket - Provision in a **Purchase & Sale Agreement** where one party may bring indemnification claims against the other only if the total exceeds a specified dollar amount. For example, the seller agrees to indemnify the buyer when all claims which are subject to indemnification exceed $1,000,000. *Contra* a cushion or deductible provision which means that only the excess over the specified dollar amount per claim is subject to indemnification or an individual or aggregate limit on the amount of indemnification available.

Best efforts clause - A clause in the **Purchase & Sale Agreement** which imposes a legal obligation on one or both of the parties to make "best efforts" to carry out the terms and intent of the agreement. A potentially troublesome provision especially if the parties do not define it, an extremely difficult task. The term connotes good faith [which is a very high standard] and reasonableness. The courts, however, are all over the lot on what this term and related terms such as "good faith", "reasonable best efforts" and "commercially reasonable efforts" mean. The lack of definition and uneven treatment by the courts provides an incentive for both parties to resolve any disagreements rather than run the risk of a court stepping in to decide the matter. See **Hell or High Water Clause** as a variation.

Bid - A proposal to buy a company, its stock, or even its assets. The term is more prevalent in public company transactions. For example, Company A proposes [bids] to buy 100% of the target company's stock for $x per share. While somewhat flexible, the term connotes more than a mere expression of interest by the bidder.

Bid Procedures - Here, the target company sets forth for bidders the ground rules for participating in an auction, for example. Bid procedures generally are considered not to be enforceable contracts or agreements. In practice, bid procedures are more like "wish lists," which bidders often pick and choose from in an effort to achieve a tactical advantage. For example, the target [actually the board or **Special Committee** through the retained **Investment Banker**] may require, as one condition for participating in an auction, that only bids for 100% of the company will be accepted. Company A submits a bid with what it considers a significant price for the shares but only wants to acquire 80% of the company because the remaining 20% [e.g., one of the divisions] is a poor performer or doesn't fit with the bidder's business plan. All things being equal, the special committee or board is free to reject the bid on this basis and even throw out Company A from the auction, although this can be risky because other aspects of the bid may be so attractive that the board wants to keep them around. In the latter instance, the bidder may be allowed to continue in the hopes that it will revise its bid or even that its bid for less than 100% turns out to have the most value for the shareholders compared with the other alternatives. I have only seen this once, but as a general proposition, the target or special committee has no legal basis for suing a bidder who does not comply with the bid procedures. Consider them to be guidelines; if you are representing a bidder, it can deviate from the bid procedures if it likes and run the risk of being thrown out of the auction. However, whatever they submit needs to be honest. It is not a good idea, for example, for the bidder to represent that it has the necessary financing lined up when it has no such assurance from its lenders. In this instance, your client may have moved from the "no contract" safe haven, into fraud, which is a whole other story, especially if securities are involved because Rule 10-b-5 potentially comes into play.

Board of Directors - Under state corporation statutes, the governing body with ultimate responsibility for the management and oversight of the corporation. See DGCL Sec 141(a). The shareholders may own the company, but they delegate substantial power to the board under Delaware law in particular, which becomes particularly evident in M&A transactions. Stated another way, the directors are the agents of the shareholders. Directors have certain fiduciary duties to the corporation and the shareholders which, if breached, can result in personal liability as well as affect the completion of an M&A transaction itself. A major focus of most M&A courses is the conduct of the board because of the statutory power they have relative to transactions. The board in turn delegates broad day to day responsibilities to management through a delegation of authority process. In reality, senior management, the officers of the corporation including the CEO, generally wield the real power over the conduct of the corporation, especially when the CEO is also the Chairman of the Board. Obviously, this can place boards in a precarious position. Interestingly, many M&A textbooks don't spend any appreciable time discussing who actually runs corporations on a day-to-day basis. It is a fact of life, however, and a potentially complicating factor for M&A transactions. See **Exculpation of Directors**, **Directors' and Officers' Insurance** and **Corporate Indemnification,** which serve to protect directors and officers from litigation arising from their alleged failure to fulfill their fiduciary duties.

Bolt- On Acquisition - Generally refers to an acquisition of a small business or product line which becomes part of an already existing division of the buyer or even the buyer itself. For example, a multi-industry company buys a small company that makes off road vehicles used for hunting and integrates the company into its golf car division. The value proposition here is that the acquired company will expand the golf car division's customer base while also taking advantage of certain **Synergies** that will result in reduced operating costs. By definition, a merger generally is not considered to be a bolt-on acquisition.

Bondholder - Typically refers to the holder of any long-term debt [**Debt Security]** of a corporation. While the Board of Directors has a fiduciary duty to shareholders, it has no such duty to bondholders. Whatever rights bondholders have is based on the agreement [Indenture] with the company that issued the bonds. Corporate bonds are the most common debt securities. As securities, they are subject to the panoply of federal and even state securities law provisions.

Break-up fee – Also known as a termination fee. This is a payment to the buyer promised by the seller in the **Definitive Agreement** if the buyer loses the deal to another bidder; although, the fee may also be payable if the deal is terminated for other reasons. In other words, this device is a disincentive to the seller to back out of an agreement, and protection for the buyer if the seller does so. Break-up fees can be controversial if they are too large relative to the deal, especially if they violate a board's Revlon duty. Boards in particular need to be careful about agreeing to large break-up fees, especially if they create a disincentive to accepting a higher bid because the break-up fee will cost the corporation more than the increased return to the shareholders from the higher bid. A general range for such fees is 1 to 4% of the purchase price.

Business Judgment Rule - A fundamental tenet of Corporations law. The rule protects directors from personal liability for business decisions except for conflicts of interest, gross negligence or intentional misconduct. Did the board act in good faith, in an honest belief that their actions were appropriate and as reasonable people would under the circumstances? This is basically the test, but under Delaware law there is a presumption that directors acted in accordance with the rule. Under the rule, the test is not whether their decision was reasonable, but whether it was rational assuming a reasonably deliberative and informed decision making process [see Smith v. Van Gorkom]. The rule exists to encourage directors to make business decisions on behalf of their corporations and discourage litigation every time they make an unpopular one. Depending on the nature of an M&A transaction, the courts may use a higher standard for assessing directors' actions, often shifting the burden of proof to the directors. See, e.g., Weinberger [but see Kahn v W&F Worldwide Corp.], Unocal, and Revlon, which are important cases which will be discussed in the course. Obviously, if board M&A related decisions are challenged in litigation, boards will do everything they can to invoke the business judgment rule. Likewise, unhappy plaintiffs will attempt to apply a higher test which may shift the burden of proof to the directors.

Business People - Your clients which you should never forget. They are the ultimate decision maker for an M&A deal; not you, although you certainly can influence the process in a major way. In most cases the lawyer is not the hub of the M&A wheel, despite what some might think. You are a spoke; albeit often a very important one. Successful business people are less risk adverse than lawyers, and they can easily view lawyers as impediments to getting the deal done, especially when lawyers don't understand their business, aren't practical, and start with the proposition that their role is to say no, as opposed to coming up with cost effective ways to facilitate the transaction, obviously without violating the law. The successful M&A lawyer understands all this and is able to navigate the relationship effectively. Let's make one thing clear; there will be times when the lawyer will need to advise the client that certain actions are ill-advised from a legal standpoint. You may be just a spoke, even a big one in the M&A wheel, but don't ever let yourself be a wet noodle, if you get my point.

Bust-Up [Break up] - For example, a transaction where a bidder intends to sell off the acquired company in parts. For whatever reason, the target's board doesn't want to sell the company, let alone sell it in pieces. Along comes our bidder, maybe a financial buyer, who concludes that breaking up the acquired company will net a significant return on investment. Assume the financial buyer acquires the target for $25 per share. If the acquired company is broken up and sold into pieces, the new owner determines it will get the equivalent of $35 per share, less expenses. The old shareholders shouldn't care what happens if the $25 share price will net them a nice gain. The target board and senior management, on the other hand, will care greatly because it means they will be out of work. Conflict when assessing the takeover bid? Of course, companies can decide on their own that breaking up the company is the only way to increase shareholder value. But if they adopt this strategy, they enter into **Revlon Duty** territory which means they must get the best reasonably attainable price for the shareholders, otherwise they face potential personal liability.

By-laws - Procedural or internal rules for governing a corporation which are critical to any M&A transaction. Think of the by-laws along with the articles of incorporation [certificate of incorporation in Delaware] as the core documents for corporate governance and decision making. The board in particular needs to pay attention to what it may or may not do under the by-laws when faced with an M&A transaction. Remember, state statues often address what can or cannot be in the by-laws, but this doesn't mean if the statute is silent on a matter it cannot be addressed in the by-laws. If you are faced with **Corporate Governance** issue involving the board, a good place to start (after you have examined any relevant state statues), are the by-laws and certificate of incorporation.

Cap - A maximum limit on **Indemnification** claims under a **Purchase & Sale Agreement**. The buyer wants the cap to be as high as possible; the seller as low as possible. Not surprisingly, this is a heavily negotiated provision in asset transactions or even stock transactions. Depending on the complexity of the transaction, keeping track of the cap or caps can be complex, which is another reason why smart companies assign responsibility for tracking indemnification obligations in the **Post-Closing Checklist** or a similar device.

Example: "Seller's indemnification obligations to buyer pursuant to paragraph 16 of this agreement shall not exceed USD 5,000,000 for any individual claim or in the aggregate."

Not perfect, but you get the idea. But ask yourself this question: how do the parties arrive at this number or more precisely, what do they need to reasonably know before they commit to the number? Do the lawyers play any role in this underwriting process? And, what is the process after the deal closes for tracking and documenting seller's loss payments under the cap? This is yet another M&A area in which lawyers often play a major role.

Cash flow - There is cash flow, free cash flow, net cash flow and other iterations which the accounting rules calculate. There is really no technical definition in the accounting literature with respect to any of these terms. But, as a practical matter, cash flows are nothing more than the amount of cash coming into a company during a particular period of time, less the amount of cash that is being spent. So, cash flow will typically be income plus depreciation and amortization less any capital expenditures and dividends and debt payments. Free cash flow is usually the term that is applied to the cash flows of the company above and beyond those cash flows associated with the need to pay dividends and spend maintenance capital. In other words, it is usually considered to be a measurement of the amount of cash flows that could be spent on other activities – such as an acquisitions or buyback of stock or operational endeavors such as research & development and new product development. For purposes of this course, understand that cash flow is an important indicator of a company's financial health, even though there can be ample cash generated by the business and no profits! Stated another way, it is generally a good thing if a company generates lots of cash from its operations. Leverage buyout firms [e.g., private equity], for example, covet a company which has good cash flow because, among other things, sufficient funds are available to pay down the significant financing for the LBO and investors generally take this as a good sign; it means the company is generating lots of revenue and has cash available to invest in the business and maybe even increase dividends, not to mention lead to an increased share price. You are going to get tired of hearing this, but cash flow is yet another data point that investors can factor into their investment decision.

Chancery Court [Delaware] - Delaware is the well-spring for most important M&A law in the U.S. Indeed, even states like Rhode Island will model their corporation law jurisprudence on Delaware law. The Chancery, or lower court, is a specialized court [no juries] where most important disputes relating to corporations law, including M&A transactions, are heard. Delaware's Chancery Court generally is regarded as a highly competent and efficient court, which explains why many other states defer to it and yet another reason why most U.S. companies of any size incorporate in Delaware. Corporate management likes certainty and consistency, and between the Delaware court system and the underlying statutory law e.g., Delaware General Corporation Law], they get this for the most part. Appeals from the Chancery Court are heard by the Delaware Supreme Court, which renders most of the major decisions affecting M&A Law.

Choice of Law & Venue - Let's take these two together because they often appear together in **Definitive Agreements**. Choice of law is the parties' agreement as to what law will apply to any dispute arising from the agreement. Obviously, this can be important. If you think that the dispute will likely entail contract interpretation, for example, and your agreement is clear and otherwise well-drafted, you might want a commercial law state like New York or Delaware, that has strict parole evidence rules and a reasonably well-settled body of contract law. Actually, choice of law decisions are more complex than this and can take into account several variables. In other words, if the parties anticipate disputes arising from the transaction, thought should be given to which state's law applies. Unfortunately, many do not give the subject much thought, and commonly revert to New York or Delaware as safe bets. They could do a lot worse; and they do.

Venue simply refers to what court or even arbitral body will adjudicate the dispute. For example, if your client's headquarters is in New York, New York and the other party is located on the moon, all things being equal, you would like any dispute to be litigated in NYC under New York law. Factors that come into play here are convenience to the parties and the quality of the judiciary and civil justice system to name two.

A typical clause addressing choice of law and venues for a domestic transaction would be:

"Any dispute arising from this agreement shall be decided under the common law and statutes of New York, conflict of law principles notwithstanding, and shall be brought for adjudication solely in the United States Federal District court for the Southern District of New York, located in Manhattan, New York."

The parties' agreement as to the choice of law and venue, with some exceptions, generally will be honored by the courts. A couple of years ago, the **Delaware Court of Chancery** upheld forum selection by-laws provisions, limiting claims relating to a company's internal affairs [e.g. derivative lawsuits; suits alleging breach of fiduciary duty] to Delaware, thus allowing Delaware corporations that adopt such provisions to avoid the costs of multi-district litigation and the unpredictability which goes with such litigation. See Boiler Local 154 Retirement Fund v. Chevron Corp, 2013 WL 3191981 (Del. Ch. June 25, 2013). Before this decision, 250 public companies adopted the provision; you can assume many more will follow. Like arbitration clauses, considerable thought needs to be given to choice of law and venue provisions. For example, I have seen several times where the parties have agreed to exclusive jurisdiction in a state or federal court only for an unhappy party to later find out that there is a lack of diversity and now they are stuck in state court. Someone was not paying attention when this provision was negotiated. In my experience, sophisticated U.S. commercial companies generally end up "defaulting" to Delaware or even New York law and their courts in their **Definitive Agreements**, especially if one or both of the parties are incorporated in these states.

Class action - A hammer frequently used by shareholders when they are displeased with a transaction, generally the purchase price, but often disclosure failures as well. Individual shareholders with relatively small holdings ban together, with the assistance of plaintiffs' lawyers, in a class of similarly situated shareholders to right their perceived wrong. For obvious reasons, shareholder class actions have an *in terroreum* effect because the potential recovery is huge, which is why the defendants' first action is generally to try to get out of the litigation on a 12(b)(6) motion to dismiss to avoid potential class certification. If unsuccessful and the court certifies the class, the price of poker goes up significantly. We could spend days on the pros and cons and ins and outs of shareholder class actions. Suffice it to say, securities and M&A related class actions are seriously unwelcomed by boards and senior management, not to mention their insurance carriers. Indeed, one recent estimate I came across is that over 95% of public company mergers valued at $100M or more result in some form of litigation, generally class actions. Having said this, most M&A related class actions are either dismissed on the pleadings, the defendants prevail on summary judgment, or the settle for relatively small amounts of money or other relief. This doesn't mean, however, that class actions are not costly to defend and disruptive to the business, or that occasionally the plaintiffs don't obtain a big judgment.

Classified or staggered board - Perhaps the most effective antitakeover defense, especially if coupled with a **Poison Pill** or some other form of shareholder's Rights Plan. DGCL 141(d) authorizes boards to include this provision in the certificate of incorporation. Basically, it limits the number of directors that come up for election each year [generally 1/3 each year]. Thus, where a board is unwilling to agree to a takeover bid, the staggered board limits the bidder's ability to quickly gain control of the board through an election of new directors, ostensibly favorable to its cause. This doesn't mean the bidder can't eventually gain control of the board, just that it may have to wait for two election cycles to do. See, e.g., the Air Products case which we will be discussing in the course. The opposite of a staggered board is a unitary board, which many public companies are moving to these days because of **Shareholder Activism**. The last time I checked, Textron Inc. had a unitary board.

Client's Objectives* - Not a formal term but a very important concept which needs to be understood by the **Deal Lawyer** as well as the entire team before the transaction commences. In other words, what important objectives does the client want to achieve with the transaction? Typically, the most important objectives are: price, speed, certainty, cost and avoiding personal or company liability, or both. Obviously, the order of importance can vary from client to client and transaction to transaction. It is axiomatic, but you cannot begin to advise your client on the structure of the transaction, the scope of due diligence, or commence negotiations and draft the definitive agreement, and undertake the myriad of other steps which the transaction entails, until you understand what your client deems important. While you won't see Client Objectives on many **M&A Timeline/Process Charts,** you would be advised to put this item towards the beginning of your list. Keep two related points in mind: your client may not know entirely what the objectives should be, which is where experienced counsel can play a valuable role by filling in the gaps, and most important, it is the rare transaction that will entirely satisfy all your client's objectives, especially if the other side has different priorities which it almost always does. Stated another way, there is no perfect transaction in terms of achieving your client's objectives, but there is the best deal under the circumstances, which means a balance between objectives must be struck. However, you have little chance of helping your client get the best deal if you don't know his or her objectives. The other part of the equation is that you have to know the advantages and disadvantages of the various deal structures to compare with the client's objectives. These latter two points are foundational for the **Deal Lawyer.** If you take anything away from this course, it is this plus the need for early planning when faced with an M&A transaction. Do not pass Go until you thoroughly understand these points.

A related term is value driver, which is a specific aspect of the transaction from the bidder or buyer's perspective, and affects one or more of the Client Objectives. Thus, value driver is a major area of focus. For example, the materials patent in the scenario at the beginning of this Glossary is a critical value driver because it will affect the price Company A is willing to pay for Company B; indeed, it is the major focus of the transaction, which means among other things, that it will be at the top of the **Due Diligence** checklist, the subject of **Representations** and **Warranties** which eventually end up in the **Definitive Agreement,** as well as other considerations.. A major environmental issue also could be a value driver, but in this case, it could reduce the price the seller is willing to pay. It is important to note that sometimes due diligence will reveal value drivers from the bidder's perspective that are not so obvious.

Closing - Not to be confused with the execution of the **Definitive Agreement,** which generally comes first for complex transactions that require certain events [e.g., antitrust approval, shareholder approval of a merger], although, execution of the definitive agreement can occur commensurate with the closing, especially in smaller or asset transactions. For complex transactions, it is not unusual for there to be a two to three month gap between the two events. The closing is when the transaction is completed, usually by the transfer of money for an asset deal or the merger is completed but only after many conditions in the definitive agreement have been satisfied or waived. While either party can sue on the agreement if the other reneges without cause, the closing is more definitive than the agreement in the sense that the transaction is generally irrevocable. Lots of important things that can affect the transaction may occur between the execution of the definitive agreement and the closing, which is why mechanisms such as **Representations and Warranties**, **MAC** or **MAE** clauses, and **Conditions to Closing** are included in definitive agreements. Just remember this: things can change with the acquired business between the execution of the agreement and the closing, and bidders or buyers in particular need to be protected in this regard. This is why smart M&A lawyers consider due diligence to end with the closing, not before.

Closing conditions - Any conditions contained in the **Definitive Agreement** which must be satisfied or waived in order for the transaction to be consummated [closed]. For example, the buyer must raise the financing it needs towards the purchase price before the deal can close **or** the seller must execute any assignments for the buyer to obtain ownership of property, contracts and the like. Not surprisingly, closings can be complicated with many documents and forms to be signed which places a premium on the deal lawyer's expertise, planning and organizational abilities. Closings can be nerve-racking experiences, but somehow they get done.

Commitment letter - An agreement by a bank or other lender with an acquiror to provide funds for an acquisition, subject to specified conditions. *Contra* **Highly Confident Letter ["HCL"]** wherein a lender basically attests they are highly confident, or words to this effect, that the acquiror will be able to obtain from them [or a syndicate led by them] the necessary financing. Bid procedures commonly contain a requirement that any bidder who intends to finance part of the purchase price obtain an HCL, as a condition of making a final bid or offer. In other words, before the target board or special committee will seriously consider the bid that is otherwise attractive, it wants strong assurance that the financing will be in place if it accepts the bid.

Compliance - Very important term in corporate America today and thus highly relevant for M&A transactions. Specifically, any company that is regulated or otherwise exposed to significant liabilities should be very concerned whether it is in compliance with the relevant local, state and federal laws. Large corporations in particular spend huge sums of money on compliance programs designed to prevent and detect non-compliance with the myriad of laws and potential liabilities companies face, and if non-compliance is discovered, hopefully fix it before the government steps in and fixes it for them and exacts stiff penalties in the bargain. Compliance is an important subject for **Due Diligence,** especially with international transactions in certain countries where the rule of law is given short-shrift and corruption rampant. China, for all its strengths as a country, would be an excellent example of this. By the way, doing due diligence in China is an extremely delicate undertaking, particularly if government owned businesses are involved. The Chinese do not like to divulge sensitive information concerning their businesses. Of particular relevance to domestic and international transactions is the Foreign Corrupt Practices Act [FCPA], which prohibits bribery of government official domestically and outside the U.S. The definitions are broad and the penalties significant. Thus, FCPA compliance, as well as compliance with other important state, federal and international laws and regulations is often a major focus of due diligence, especially in merger transactions where the buyer assumes the liabilities of the acquired company by operation of law. Moreover, it's the rare definitive agreement that does not contain one or more **Representations and Warranties** that the acquired company is at least in material compliance with all relevant laws.

Confidentiality Agreement [Non-Disclosure Agreement-NDA] - This document basically provides for protection of confidential information shared as part of the transaction, or even discussions with other third parties, including potential suitors or targets. It is generally one of the first steps in the M&A process because it facilitates the flow of information between the parties, which is necessary for valuation purposes or to establish the bona fides of the bidder or buyer. This can take the form of a stand-alone agreement [e.g., prior to the commencement of due diligence] or even a provision in the definitive agreement. For our purposes, the agreement obligates the buyer [it may be reciprocal] not to disclose to parties outside the transaction such matters [unless required by law] as the deal itself, confidential or business sensitive information it receives in due diligence, and the like. Confidentiality agreements generally survive the termination of negotiations for an agreed upon period of time.

The parties can spend countless hours negotiating the terms of a confidentiality agreement, including the remedy provisions for a breach. If the confidentiality agreement proceeds actual due diligence which they generally do, this process can consume valuable time and money. Your clients may not appreciate "sucking up" valuable time and money in this manner, especially if they want to fast track the deal or control costs or both. See Client Objectives, above. At the same time, if your client signs a confidentiality agreement and then doesn't pay attention to it, this can lead to problems for them. Because damages for breach of a confidentiality agreement may be difficult to calculate, liquidated damages clauses often will be included along with the right to seek injunctive relief. One more part of the M&A process for the deal lawyer to manage.

Conglomerate [denoted "Multi-Industry" today] - A company which consists of several diverse businesses, ostensibly with minimum centralized management. Think mutual fund. Textron Inc., which we will be spending time on, generally is regarded as the first conglomerate tracing its history back to 1927 and its founder Royal Little, a Rhode Islander. Today Textron consists of aviation, aerospace, defense, finance and industrial/consumer products businesses with annual revenues of $14B. After WWII, Royal Little decided to transform what was basically a textile company into a diversified company consisting of many dissimilar businesses. By the mid-50s, he had divested the company of its last textile business and in the next twenty years, embarked upon a series of acquisitions of companies which made chain saws, milling machines, helicopters, aerospace products [e.g. the Mercury space program components], servo-actuators for aircraft, hovercrafts, silverware, pens, watches, golf cars, industrial fasteners, industrial presses, paint products, a cruise ship, [the Lilanni which was an absolute disaster], auto parts, optical equipment–to name just a few. He even started a finance company [or at least one of his successors did] which grew into a multi- billion dollar business before it was largely liquidated in 2013. Of course, Textron sold [Divestitures] almost as many companies as it bought over time, to the point where if you put together all the companies Little and his successors sold and acquired Textron would be bigger than GE. In any event, the assumption was that if one or more of the businesses were not doing well, the other dissimilar businesses will even things out. As I said, think mutual funds. GE is another example of a conglomerate. Berkshire Hathaway is arguably the closest to the original model in its diversity and lack of centralized management. For a number of years Textron confined itself to small bolt-on acquisitions, which changed in 2014 with the $1.4B purchase of Beechcraft, discussed below. In recent years, there has been much skepticism concerning the usefulness of the conglomerate business model in terms of shareholder value, yet conglomerates still exist and many of them are doing quite well. The last time I checked, Textron's stock was trading in the $46 range, up from a low of $3.40 during the Recession of 2008 where several of the company's businesses got hammered all at once. When a company acquires another company, which is in a different business entirely, this is sometimes referred to as a conglomeration or multi-industry merger.

Finally, here is a snap shot of Textron's M&A experience since the 1980s: Around mid-1984, Chicago Pacific Rail Road, which was rich in cash, made a hostile bid that Textron was able to fend off in large part because the bidder didn't know what it was doing. To make itself more takeover-proof, as well as expand its revenue base, in 1985 Textron acquired Avco Corp., a multi-industry manufacturing/financial & insurance service company for $2B [cash-for-stock friendly merger]. In 1989, Textron acquired Cessna Aircraft Company, a leading manufacturing of business jets and general aviation piston aircraft for $800M or so in cash, and in early 1990, acquired Ex -Cell-O Corp, a multi-industry manufacturing company for around $1B. Throughout this period, Textron is shedding businesses it doesn't need, which continues to the mid 2000s. Then, for reasons that will become apparent in the course, the company commenced a series of smaller, "bolt on" acquisitions and was forced by the great recession of 2008 to liquidate over $10B of receivables held by Textron Financial Corporation, its finance subsidiary—one of the most successful liquidations of its kind in the annals of U.S business history. In 2014, Textron deviated from is acquisition strategy, by agreeing to buy Beechcraft Corporation [technically, its parent company] for $1.4B which consisted of cash on hand and substantial financing. Beechcraft manufactures high end piston engine aircraft, among other products, and was folded into Textron's Cessna Aircraft subsidiary to supplement it general aviation product lines. It is fair to say that growth by acquisition is part of Textron's business strategy, although if you asked the CEO, he would be quick to say that the primary strategy is growth through new product development, which it is. Stated another way, Textron would prefer to grow organically but recognizes the benefit of growth through M&A activity as well.

Constituency Statute - A state statute that, inter alia, allows boards facing a takeover bid or other business combination to consider, in addition to shareholder interests, the interests of the company's employees, customers, suppliers and local communities and even environmental concerns. Thus, it operates as a kind of antitakeover statute, but probably has greater implications for who the board selects as a bidder in an auction context. For example, the fact that one bidder offers a higher price than another bidder, doesn't necessarily mean the board has to accept the higher bid, if to do so would adversely affect the interests of other constituents. These statutes are largely untested in the courts, although as we will discuss, there are a few decisions in Pennsylvania, which appear to allow the constituency statute to trump the board's Revlon duty. In any event, because many of these laws are new, it is still unclear whether they will modify the **Revlon Duty**. Personally, my sense is that they may be a factor which the board can consider as part of its Revlon duty, as opposed to abrogating the duty. Very confusing area of the law. As discussed previously, some companies are amending their corporate governance documents to include constituency provisions. Arguably, if the shareholders have approved such a provision, it carries more weight than a statute.

Control - A person or entity controls a company if they have the power (through stock ownership or otherwise) to direct or significantly influence the company's management or policies. More than 50% ownership in the target can be clear indicia of control. However, because of the dispersal of shareholders, significantly less than 50% ownership can equate to control. For example, depending upon the circumstances, a 10% ownership of a company's shares may be control. Control is an important concept in terms of assessing whether there has been a conflict of interest, which may serve as a basis for a shareholder challenge to a transaction. This is the Weinberger case, which will come up in the second half of the course. Additionally, the critical distinction between an M&A transaction and a strategic alliance [e.g. partnership, joint venture] is that the acquiror controls the required company or asset. Finally, if a transaction will result in a change of control for the target company, this is tantamount to the company being **In Play**, which triggers the board's heightened **Revlon Duty.** See, e.g., Paramount v Time-Warner; & QVC v. Paramount. The concept of control also has important implications for liability under the federal securities laws.

Control Share Acquisition Statute - Another type of state anti-takeover statute which typically denies voting rights to a purchaser who acquires in excess of 20% of the common stock of the target company unless such purchaser first obtains the permission of the target's **Shareholders** at a special meeting.

Corporate Formalities - The statutory formalities that must be satisfied for an M&A transaction to be completed. The most critical formalities are board approval, shareholder approval by vote, and the availability of appraisal rights. Some or all of these formalities may apply to both parties to the transaction and thus, the deal lawyer needs to factor in the other side's requirements as well as his or her client's. For example, it doesn't do much good for the bidder to satisfy all of its formalities, if the target is unable to do the same. The **Structure** of the transaction will directly affect the formalities. The starting point for determining the necessary corporate formalities is the governing states' corporation law. The articles of incorporation and by-laws should not be over-looked. Failure to comply with the formalities can lead to a shareholder lawsuit to enjoin the transaction, or damages or rescission after the deal closes, although the latter is rarely granted. Other "formalities" may be necessary to consummate the transaction, such as SEC or DOJ/FTC requirements and even those of a national exchange [e.g., NYSE] if one or both parties are members.

Corporate Governance - A broad term which basically includes the laws, rules, procedures, practices and guidelines, both external and internal, which create a framework for companies to govern themselves and their various constituencies, such as directors and shareholders, in the conduct of their businesses. As previously discussed, the certification of incorporation, by-laws and state corporation law requirements are core corporate governance documents. Compliance programs come under the rubric of corporate governance. The **Sarbanes-Oxley Act of 2002**, with its increased financial reporting, enhanced auditing and senior officer certification requirements for financial statements, is typically regarded as a corporate governance law, though the SEC enforces it. This is an area where the securities laws and regulations intersect with state corporate governance laws and practices, which presents interesting federalism issues.

While not especially germane to this course, many corporations, especially public corporations and those who do business with government agencies, will add to their corporate governance portfolio "Business Conduct Guidelines ["BCGs]" or Code of Ethics which can be best summed up as ethical guidelines for how the company is to conduct its business. For example, "X Inc. will endeavor to conduct its business worldwide in strict compliance with the relevant laws and regulations of the countries and localities it does business in." Failure of an employee to comply with the law can be the basis for disciplinary action under the BCGs.

Covenants- Basically, a covenant in a **Definitive Agreement** is a promise by one or both of the parties to the transaction to do or not do something either before the closing or occasionally after. For example, the target covenants not to make any material changes to its business between the execution of the definitive agreement and the closing. If you look at a standard definitive agreement-they generally follow the same format for meaningful transactions-you will see separate sections for closing conditions, covenants, and representations and warranties. While they have common aspects, they are different terms which some lawyers have difficulty remembering. The remedies for violation of these provisions can include termination of the transaction and post-closing indemnification. Stated another way, they are important contractual provisions which can dramatically affect the transaction, and thus often are the subject of intense negotiations and should not be agreed to cavalierly.

Culture - Every company has its own culture, which can basically be described as the way it goes about its business, operations and management of its employees. For example, Facebook and Google tout a culture of innovation, group idea sharing, non-hierarchical decision making, almost anything goes dress codes, lots of treats for the employees and the like. Whereas, more traditional companies, such as Textron Inc., have a culture which is more hierarchal, process oriented, less individual autonomy and rules and procedures driven, although I suspect the company would disagree with my characterization. Culture is neither intrinsically bad nor good; it is what it is, but it is almost tangible. Understanding the culture of the target company is important for an acquisition, because when the deal closes, **Integration** of the new company or division will need to occur. If the cultures cannot be reconciled, this may spell problems that can imperil the business. For example, the key managers from the acquired company may flee, either before or after the closing because they are used to operating with more autonomy than the acquiror allows. Smart companies start assessing the culture of the target or seller early in the due diligence process at least to make sure that the two entities can work together, or at least plan for how to integrate the cultures. An international or cross-border transaction can present even greater cultural challenges for obvious reasons. Cultural differences are not necessarily insurmountable; people can adapt. Waiting to sort this out until after the deal closes is generally not advisable when there is a cognizable gap in cultures between the acquiror and target. This isn't for the lawyers to sort out on a macro-level, however. This is a job for the business people.

Cumulative Voting - A method of voting that is either permitted or required by state corporate law that improves minority **shareholders'** chances of electing a representative to a Board of Directors. In regular voting, Shareholders must apportion their votes equally among candidates for Director. Cumulative Voting allows a Shareholder to aggregate all his votes and cast them for a single nominee. For example, in an election of Directors where there are eight nominees for six Director positions, if Cumulative Voting were permitted, a Shareholder with 1000 shares could elect to cumulate his votes and cast 6,000 votes for a single Director or split his vote among the nominees as the Shareholder chooses. This is a popular item for Corporate Governance advocates but remains the exception rather than the rule.

Data room - The location where target's documents and other information are placed for review by potential bidders as part of the all important formal or legal **Due Diligence** process. Data rooms can be physical or virtual or both. Generally, the potential bidder provides the target [or its **Investment Banker** if one is involved] with the list of documents and other materials by category [e.g., all profit and loss statements for the last five years, all insurance policies for the last ten years, list of all pending litigation or claims]. The bidder wants to get as much information as possible to allow it to determine the value of the target, contingent liabilities, etc. The target often wants to give as little information as possible without killing the deal, especially if it is unfavorable, and still satisfy the bidder's requests. Keep in mind that for public companies, potential bidders also perform due diligence through public filings [e.g., 10Ks, 10Qs, press releases] and industry sources well before they get to the data room. As a lawyer involved in an M&A transaction, you may be spending a lot of time in data rooms along with other non-lawyers such as accountants, HR types, environmental specialists, anti-trust lawyers, etc. If the bidder's stock is the consideration, the target is going to perform a more limited due diligence on the bidder as well as consult other sources of information [e.g., **its Investment Banker]** to ensure that it can support the share price post-transaction. And keep this in mind, data room's, especially physical data rooms, contain a lot of "raw" information which is not always presented in a clear and organized manner, let alone complete or easily understood, which is why frequent and intense discussions and follow up requests with the target or seller's representatives is the norm for most transactions of any size. Yet another cost item for your client as well as a slowdown of the process, both of which may be contrary to one or more of your client's business objectives.

In recent years, virtual data rooms have become a common practice for many companies, especially because they provide easy and efficient access to financial data and similar materials at a lesser cost than making the information available in a physical location. One word of caution here, however. Often the data or any other information provided is either incomplete or requires explanation. Yes; this can be done electronically or telephonically, and many times this is the best way to proceed. There is no substitute for face to face communication in M&A transactions, especially when important matters need to be discussed and relationships built. Physical data rooms staffed with key personnel from the target can serve both of these purposes and thus should not be abandoned entirely at the altar of the computer. Also, 'kicking the tires" of manufacturing facilities, for examples, can be a highly productive part of due diligence.

Deal Flow - Same as **M&A Timeline or Process.** Almost every transaction—whether big, small or in the middle, whether in the U.S or international—tends to follow the same basic steps or timeline, although not necessarily always in the same order or involving the same events. Hence, the term "deal flow." The concept is relatively simple; it's the execution which presents the challenges. If you are serious about working on M&A transactions, you will need to master deal flow because it is the step by step process for the completion of the transaction. Also, as implied, depending on the transaction, some of the steps in the standard deal flow can be dispensed with or modified. There are certain steps in most M&A transactions which cannot be dispensed with such as some due diligence, a definitive agreement and a closing, to name three. Interestingly, companies differ on how formal the deal process is. Some companies follow a step by step procedure which they tend not to deviate from; other companies are less rigid in their approach to acquisitions. Either can work depending on the acumen of the company and its deal team. Frankly, as important as the process is, if the acquiror hasn't done a thorough and competent valuation of the target to support is **Economic Value Proposition**, the best process in the world is unlikely to save the transaction.

Deal Lawyer - This is the lawyer who is primarily responsible for **Structuring** transaction from a legal perspective, including legal due diligence, regulatory filings, drafting and often negotiating the definitive agreement with the business people and facilitating the closing. For truly big deals and sophisticated clients, this is generally a lawyer [and a supporting team] with a firm that has extensive M&A experience such as Skadden, Arps or Watchtell, Lipton. Occasionally, especially if the deal is a small one, the client will handle this function entirely in-house with a member of the legal department. For most of the M&A work you are likely to experience, however, the client will not have the benefit of an in-house legal staff and will need to hire outside counsel. Irrespective of where the deal lawyer comes from, he or she is a critical **Stakeholder** in the M&A process. Indeed, experienced transactional lawyers may be asked to offer more than just legal advice, especially with small or unsophisticated clients, which many of you are likely to encounter. When lawyers slip into this mode, maintaining privilege becomes an issue. When they assume this role on their own, they risk irritating the client, however. What you need to watch out for when dealing with less sophisticated clients is they may want to use you as a "crutch" to help them sort out business issues as opposed to purely legal issues, although as we shall see in this course, the lines between the two can blur, the classic example being when the deal lawyer is involved in negotiating the deal or aspects of it. Like I said previously, the successful M&A lawyer often has to be more than technically proficient.

Debt - The sum total of borrowings (e.g., loans, bonds) a company has. Debt can be a takeover defense for obvious reasons, or it can be a purchase price factor. It also can be an impediment to acquisitive transactions. If you have a lot of debt, it may be difficult to raise financing for a transaction or any increased debt could have an adverse impact on operations. Not surprisingly, a target or seller's debt is an important item on a due diligence checklist, especially in a merger. This doesn't mean that debt is necessarily a bad thing, especially if the capital is being used to grow the business and the debt can be serviced without adverse consequences to the business.

Debt Security - A security representing a corporation's promise to pay back borrowed money [principle] plus interest. Bonds, notes and debentures are examples of debt securities. The offering of debt securities can be used to raise capital for an acquisition as well as general operational needs. Remember, however, that debt securities are subject to the federal securities laws which may add a level of complexity to any potential M&A transaction. Issuing debt securities for purposes of raising capital is known as debt financing.

De Facto Merger - Term for a denominated asset transaction that values substance over form. In other words, while the parties may style the transaction as an asset deal, in effect it is a merger which can expose the buyer to **Successor liability** it otherwise seeks to avoid and other issues such as the right of the shareholders to approve the transaction or seek appraisal rights. Delaware courts don't think much of the de facto merger doctrine which is exemplified by the "Significant Independence Doctrine." This doctrine holds that under Delaware law as long as the transaction is structured to meet the statutory requirements of an asset deal [DGCL 271], it is irrelevant that it also could have been structured as a merger under DGCL 251. This is a good illustration of why the **Internal Affairs Doctrine** is important. Other states [e.g., California, New Jersey, New York] embrace the de facto merger doctrine in varying degrees. There are other ways to get around asset transaction immunity from successor liability, such as fraud, the "mere continuation" theory and the product line, environmental and labor exceptions, although the latter are relatively limited.

Defensive Measures- A panoply of measures a company may take to ward off an unfriendly suitor [hostile takeover].The two step standard for assessing a board's adoption of defensive measures is set forth in the **Unocal** case and its progeny. Defensive measures include a staggered board and a Poison Pill, which are the two most potent such measures. Antitakeover statutes, assuming they are not waived, also act as a defensive measure, and they have the benefit of not requiring the board to do anything but comply with them. The efficacy of a constituency statute as a defense measure remains to be seen. A variant of defensive measures are provisions in a definitive agreement which protect the bidder from losing the deal. No shop clauses and termination fees are two common such devices. Curiously, the standard for assessing these devices in Delaware is split between application of the Revlon Duty and Unocal two step standard. In any event, under Delaware law, target boards have considerable leeway to adopt defensive measures so long as they are reasonable in relation to the threat and do not materially preclude bidders or impede shareholders from having a meaningful vote on the transaction.

Definitive Agreement - A binding agreement that memorializes an M&A transaction. For an asset transaction, the **Purchase & Sale Agreement [PSA]** or some variation is the definitive agreement. For a merger, **the Merger Agreement** fits the bill here. A stock purchase agreement addresses the purchase of the target's stock. The Galaxy/Trekker transaction which is discussed in the text offers a good example of a stock purchase. See appendix C.

Delaware - As previously stated, the well spring of most corporation law in the U.S. including M&A law. Here is where most large companies incorporate, mostly to take advantage of the generally favorable statutory law and relatively stable and predictable judicial decisions. Corporations are creatures of state law and the **Internal Affairs Doctrine** requires foreign courts to apply the law of the state of incorporation of the parties to most corporate governance and corporate formalities relative to an M&A transaction. Thus, another reason why the overwhelming majority of companies of any size opt to incorporate in Delaware, even though their headquarters are often elsewhere. Yes, most states have their own corporation law, some modeled on Delaware's or on the Model Corporations Law, or some combination of both. Obviously, federal and state regulatory regimes cannot be ignored. All things being considered, however, Delaware is where most of the important M&A law is derived from, and that's why it is a focus of this course. Moreover, as a general proposition, Delaware statutory law and the courts' interpretation of the law are considered to be enabling of corporations as opposed to restricting them and this includes M&A transactions. This is not necessarily the case with other states or the Model Code. In recent years there has been talk of a "flight from" Delaware to other states in terms of governing principles, but a recent survey concludes this has abated somewhat and Delaware remains the clear leader in terms of developing the contours of M&A law. Interestingly, Maryland of all places recently amended its corporation law which appears in many respects to be even more favorable than Delaware's. Frankly, it is not clear that this will be enough to attract corporations given some of the other less friendly business laws.

Delaware General Corporation Law - [DGCL]. If you are faced with an issue involving corporate governance or a merger or acquisition, <u>once you understand the facts and the issue,</u>

check first to see whether the matter is addressed by a state corporation statute [s], and then if necessary, a federal statute [s]. The statutes are foundational. Then you can turn to the certificate of incorporation, by-laws, etc., and case law if the statute is not sufficient for purposes of resolving the issue, which it often is not. But keep this in mind, Delaware's corporation law my not apply entirely to a transaction, especially if one of the parties is incorporated elsewhere. And, while many states model their corporation law on Delaware, there can be important differences. For example, California's corporation law, which appears throughout the text but we will not be spending much time on, differs from Delaware's in several important ways, especially in terms of protecting minority shareholders' voting and appraisal rights.

Derivative Suit - A suit filed by a shareholder on behalf of the corporation, alleging that the corporation's directors and officers (or some other person) wrongfully damaged the corporation. Often filed as a class action and often dismissed on the pleadings or summary judgment for reasons we don't need to go into here. As a theoretical matter, these suits should be hard to win even if not dismissed early, because absent a conflict of interest or bad faith on the part of the board or senior management, the business judgment rule affords defendants significant leeway in decision making.

Dilution - Diminution in the proportion of income to which each share is entitled. Transactions are often measured by the amount of dilution the acquiror's common stock will suffer as a result of the transaction.

Directors' and Officers' Liability Insurance - An insurance policy that covers directors and officers for expenses, including attorneys' fees [which may be advanced if permitted by state law], judgments and settlements arising out of lawsuits against them in their official capacity. For large companies, the policy often will contain a significant retention [e.g., $5M] which basically means the first $5M of defense and indemnity [e.g., settlements or judgments] costs are borne by the company, then real insurance money kicks in up to the limits of the policy. Interestingly, Fortune 500 companies generally purchase D&O coverage with limits in the $250M to $300M range, which is not a lot of money when you consider a 10b-5 securities class action which can seek billions in recovery. The premiums can be pricey. Along with this insurance, most companies provide their Ds & Os with corporate **Indemnification** as permitted by the relevant state law. Delaware has the most expansive provision in this regard, which is yet another reason many companies incorporate there. Think of the indemnification provision in the by-laws as filling the gap [e.g., retention] in coverage which means all things being equal, the directors and officers should not have to pay $1 of their personal funds if sued, although depending on the nature of the allegations, indemnification may be voided. Depending on the language [generally in the by-laws] and facts, it can be more complex than this but you get the idea. Keep this in mind, however, especially when dealing with smaller companies: an indemnification provision is only as good as the assets which back it up, which is why D&O insurance is generally a must.

Disclosures- Public or reporting company periodic reports [especially, 10K, 10Q & 8K] under section 13 (a) of the Securities Exchange Act can be important sources of information for purposes of "informal" due diligence. In other words, a significant amount of financial and operational information is available in the preliminary stages of a transaction or even as part of evaluating the transaction in the first instance. There are other disclosures such as press releases, investor calls and the like which also are publically available. Obviously, due diligence is generally necessary to confirm these disclosures, or at least material aspects of the information provided. Depending on the companies involved, the nature of their businesses, the type of transaction, etc., formal due diligence may be greatly abbreviated based on the wealth of information available in the public domain. See the Pfizer/Pharmacia $60B merger discussed in the text; formal due diligence was less than two weeks. This wasn't totally a function of the two company's public filings but they certainly contributed to this. The point here is pretty simple: the more information the bidder or buyer can obtain on the target or seller without having to spend too much time and money to get it, all the better for valuation purposes.

Dissent - See Appraisal Rights above. Under many state corporation statutes, shareholders must dissent [e.g., not vote for the merger] before they can seek their appraisal rights in court. This is part of the "perfection" process. The relevant statutes also may require other procedural steps before the dissenting shareholders can go to court to assert their rights. See DGCL 262 which contains several steps that need to be taken for appraisal actions which if not followed, negate this remedy.

Drop-Dead Provision - A provision in the definitive agreement specifying a date after which either party may terminate the agreement if the closing has not occurred.

Due Diligence - Formal or legal due diligence [as opposed to " public due" diligence such as reviewing public filings] is an often under-valued but absolutely critical part of almost any M&A transaction—big, small or in between. Think of due diligence as a risk identification and minimization tool for the bidder or buyer. It also serves the purpose of providing information to support valuation as well as identification of hidden value drivers. At a minimum, it provides the bidder or buyer with a better idea of what they are actually purchasing. Due diligence is a continuous process which often starts before a **Management Presentation,** if there is one, and continues to the closing in many cases. Here is where the buyer attempts to get as much information [formal due diligence means due diligence done pursuant to the transaction] concerning the target or seller's business so it can value the company for purposes of determining whether it should make a bid or proposal, what **Structure** is most advantageous and, most importantly, the price it is willing to pay. This includes determining and quantifying any contingent liabilities or obligations ["risks"] which the target or seller presents. Sophisticated companies gather a team of functional experts— including lawyers—and prepare a thorough "due diligence checklist" which divides the target [or any of its target businesses] into functional categories [e.g., financial, operations, product mix, environmental, human resources, litigation, warranty claims, insurance coverage, government investigations] with a series of questions/documents that need to be answered or obtained under each area of inquiry. Depending on the size of the transaction, due diligence can be extremely expensive and lengthy; the later raising the risk that word will get out and other bidders, for example, may enter the fray or annoying the target company with overly burdensome requests which can have an impact on negotiations or both. Thus, many will prioritize or "tailor" their due diligence checklists to fit the client's objectives and the nature of the target or seller.

Lack of an effective due diligence process can turn what seems like a good deal into a bad one for the buyer. For example, if the due diligence team fails to uncover the fact that twenty years ago the seller made products with asbestos and doesn't ask for a representation in this regard and assumes liability for all post-closing litigation, what happens? All of a sudden, the plaintiffs' bar decides it has found a new source of asbestos claims—the seller's old products—and the buyer is now on the hook for substantial defense costs and indemnity payments and has no insurance. Thus, the cost of the acquisition has now gone up considerably, perhaps to the point where the acquisition is a bad investment. I have seen this happen, trust me. Due diligence is very important but it has to be done right and it has to be constantly updated right up to the closing because things change. For example, cash flow projections which supported **Valuation** of the target early in the transaction may undergo material change towards the end of due diligence or even after but before closing. Keep this simple "formula" in mind: due diligence = current information = valuation of target company = purchase price = no unanticipated post-closure loses = greater chances of a successful transaction. See also data room, where most of the information obtained as part of formal due diligence is located, albeit often incomplete or in a form which requires explanation or both. Also, keep in mind compliance and integration are important items on the buyer's due diligence checklist. See Appendix E in the text for a sample due diligence checklist.

Note: broadly speaking, due diligence can be broken into three broad categories—finance/accounting, operations, and legal [e.g., known and unknown liabilities].

Duty of Care - One of the fundamental principles of corporate law is that directors [and officers] owe fiduciary duties to the corporation and shareholders. Breach of these duties can subject such persons to personal liability as well as spell trouble for an M&A transaction itself. The duty of care applies to the director's obligation to manage the affairs of the corporation responsibly. For example, if a board approves a major acquisition which turns out to be a disaster, the board is open to potential shareholder litigation for breaching its duty of care. If it takes on too much debt, this also may be a breach of this duty. In Delaware, as in many other states, the board's actions will be subject to the business judgment rule in straight forward duty of care situations, which as discussed previously, presents a high hurdle for plaintiffs to get over. After the infamous <u>Van Gorkom</u> case, most boards of large companies have enhanced their decision making processes to further ensure that they can demonstrate they made an independent, informed and deliberate decision in satisfaction of their duty of care and **Duty of Loyalty**. See **Exculpation** for a device which can insulate directors [not officers] of Delaware corporations from personal liability in lawsuits alleging a breach of the duty of care.

Duty of Loyalty - The other major fiduciary duty owed by directors. Under this duty, directors are obligated to act in the best interest of the corporation and shareholders as opposed to any self-interest or other conflict. In other words, the corporation and shareholders come first. This does not mean that director's necessarily breach this duty if they have, for example, a personal or financial interest in a transaction. Rather, that interest must be disclosed and may not be the material factor which is driving the directors' decision or action. The business judgment rule is not applicable to allegations of breach of this duty. A much higher standard is applied, which can result in the burden of proof shifting to directors. Many M&A related lawsuits involve allegations of a conflict of interest by directors or senior management, and occasionally their external advisors. Transactions that involve "squeeze out" mergers of minority shareholders by controlling shareholders present the potential for a breach of this duty. This is the famous <u>Weinberger</u> case, which recently has been mooted to a large extent by the <u>Kahn</u> decision in the context of such mergers, provided the controlling shareholder follows the six step process approved by the Court. Today, most boards have a large number of **Independent Directors** to lessen the potential for conflict of interest situations and will set up **Special Committees** consisting solely of independent directors for certain transactions [e.g., Management Buy Out].

Duty of Good Faith - Here is where things get a little confusing. Some states recognize this third duty which appears to be a hybrid of the duty of care. For example, if a board consciously and intentionally disregarded their responsibilities, adopting a "we don't care about the risks mentality" concerning a material corporate decision, this would be an independent basis which would negate the protection of the business judgment rule. In Delaware, the duty of good faith appears to be a default position under the duty of loyalty. In other words, if the directors make a bad decision that doesn't involve a conflict of interest or would otherwise be co-opted by the duty of care or an exculpation provision in the certificate of incorporation, angry shareholders can argue lack of good faith. This is a high hurdle to get over, however. The best example of this in the context of a M&A transaction can be seen in the Lyondell Chemical case which we will be discussing in great detail.

Earnings per Share [EPS] - A term generally used by public companies as an indicator of profitability. EPS represents part of a company's profits allocated to each share of outstanding common stock. Thanks to our friends an Investopedia, the formula looks like this:

Net income-Dividends on Preferred Shares
divided by = EPS
Average Number of Outstanding Shares

So, if a company has $30M in net income, pays out $2M in preferred dividends and has 28,000,000 common shares outstanding, its EPS is $1.00.

For reasons best left to the securities course, EPS is not an entirely accurate indicator of how strong a company is for M&A **Valuation** purposes, but it is nonetheless frequently used to measure profitability, especially as part of a public company's quarterly earnings report. Projected increases in EPS are a good thing for the shareholders, because all things being equal, it will equate to a higher stock price. Expect a seller to tout its EPS [if it is high and projected to continue to be high or higher] as part of its pitch to get a higher price from the buyer, but as in many matters attendant a M&A transaction, the buyer needs to "get behind" [understand] the numbers as part of it valuation of the seller. For example, if a company does a self-tender which results in a large number of shares being removed from the market, its EPS will increase. This does not necessarily mean that the company has undergone a corresponding increase in growth or profitability.

Earn-out - Type of **Post-Closing Purchase Price Adjustment**. This is a provision in a definitive agreement, generally an asset transaction, providing the seller's shareholders with the right to receive additional consideration after closing if the company's earnings over a specified period meet certain thresholds, or more precisely, targets (metrics). While the concept is relatively simple, in practice earn-out provisions can be complex [e.g., what are the thresholds or metrics and how are they measured?] and often are extremely difficult to negotiate because both sides have something to gain or lose, let alone enforce. For example, Company A pays $400M for Company B which only agrees to this price if its shareholders have the right to get additional consideration from Company A once it operates the business that was Company B. So, Company B gets Company A to agree in the purchase and sale agreement or occasionally a separate agreement which is an **Exhibit** that if revenues attributable to the former Company B in the first year exceed a certain number, B's shareholders will get another $x. Good luck Company B. Even though they may have access to the books and records of Company A, the latter has the business and controls all the information plus prepares the financial statements for the new business. Get the idea? In any event, earn-out provisions can be an important device to bridge the gap if there is a price dispute. If the parties are dealing in good faith, they can work quite nicely. Because earn out provisions can be complex and entail arcane accounting principles, the parties often will insert an ADR provision [generally, a public accounting firm] in the definitive agreement which identifies a public accounting company to act as an arbitrator of any dispute.

A related device which can complicate negotiations and post-closing activities is the use of an escrow account to hold back some of the purchase price, subject to certain events occurring. For example, if the buyer is concerned that the seller will not have sufficient assets to cover indemnification obligations it has [e.g., products liability], it may require that the seller to hold back part of the purchase price in an escrow account with an independent escrow agent. Escrow agreements are generally easier to draft than earn our provisions, but care should still be taken by both sides. See the <u>Trekker/Galaxy</u> deal for use of earn outs and escrow accounts.

At least three major points need to be considered here. First, drafting earn-pout provisions can be extremely complex and require the involvement of people with accounting and operations expertise. It is the rare lawyer who can draft these provisions on their own from scratch for substantial transactions; nor should they. Second, earn-outs, escrow accounts and purchase price adjustments reveal that the price for a transaction often is not fixed as of the closing, which comes as a surprise to most law students. Finally, if the transaction is run right and the parties have established a reasonable relationship of trust, which isn't always easy, these provisions can be deal facilitators and shouldn't be avoided simply because they present risk.

EBITDA- This is not an accounting course, although this discipline plays an important role in M&A transactions. In any event, this is a term which you probably should have some awareness of because it generally is an important consideration in **Valuing** a business for acquisition purposes. EBITDA stands for earnings before interest, taxes, depreciation and amortization. Basically, it is a measure of the cash flow of a company. The higher the EBITDA the better.

Economic Value Proposition - Not a technical term per se but a very important concept. Basically, what value does the bidder or buyer anticipate it will receive from the transaction? Absent a desire to acquire another business or part of a business to feed the CEO's ego ["personal value"], the buyers' primary objective should be to achieve material growth from the acquisition. If the transaction is not going to contribute materially to growth in some way it makes no sense to pursue it, and indeed, the board could be in breach of its fiduciary obligations if it approved a transaction that everyone knew would not grow the business, especially if it destroys value. So, the board is going to want to hear from the CEO what he or she thinks the value proposition is and then make its own independent determination. Although related, the economic value proposition is not the same as your client's objectives for the transaction; although attaining the objectives should serve to achieve the economic value proposition. <u>Keep this important statistic in mind: a high percentage of all public company acquisitions fail, that is,</u>

do not achieve the buyer's economic value proposition or worse, destroy value. Why? Often because the buyer either didn't do the analysis necessary to clearly identify the EVP or built in some aggressive assumptions [e.g., **Synergies**] that proved erroneous. Sobering thought and it makes you wonder why so many companies engage in M&A transactions. See the Pfizer/Pharmacia merger for a classic example of a wildly failed transaction, at least in the short run; however, in fairness to Pfizer, they caught a bad break when the major drug they acquired from Pharmacia had the misfortune of being equated with a similar drug that was recalled by the FDA, which caused sales to slump significantly.

Engagement Letter - For purposes of this course, the agreement between a bidder, target or Special Committee and an **Investment Banking** firm or other financial adviser for services rendered by the professional in connection with a proposed acquisition, sale or takeover defense. Engagement letters usually cover the exact duties of the adviser, its fees and extensive indemnifications against legal liability and litigation expenses. It is extremely rare in a major acquisition for both sides not to hire investment bankers or other financial advisors. Yet another stakeholder in the M&A process and a very important one depending on the nature of the transaction.

Entire Fairness Test – The highest standard for evaluating board decisions under Delaware law first enunciated in the Weinberger case, which was recently qualified in Kahn v. W&F Worldwide Corp. Most commonly comes up in the context of a controlling shareholder who seeks to squeeze out minority shareholders in a second stage merger. It actually presents the directors with an opportunity to save flawed decision making, although the burden of proof is initially on them. The test contains two elements: fair procedures and a fair price for the tendered shares. Interestingly, it is not entirely clear under Delaware law whether a fair price moots unfair procedures, although you would think so given that the gravamen of the dispute is damages if the price is unfair. Weinberger also is instructive on how to value the price offered for the target's shares in appraisal actions.

Caveat: Arguably, the highest standard for evaluating board decisions is any action which impedes or unduly interferes with the shareholders' voting power. The Delaware courts tend to apply a strict scrutiny test here.

EH&S – The Environmental Health and Safety function within a company. A potentially important due diligence item and function represented on the bidder or buyers due diligence team, especially if the target is a manufacturing company that has plants that use hazardous materials and generate lots of hazardous waste and lots of employees that create OSHA issues. See, e.g., **Superfund.** In my experience, if the target or seller has a strong EH&S department, this will facilitate environmental due diligence and increase the bidder's confidence in the reliability of the information it has been provided, which can save time and money in this area of due diligence.

Early Planning – A critical concern for the deal lawyer and his or her client. Because M&A transactions can raise a myriad of legal and business issues including involving numerous internal and external stakeholders all of which can imperil the success of the transaction, such issues need to be identified early including how they will be addressed. A simple example is antitrust. Irrespective of whether the transaction involves a horizontal or vertical merger, the size of the transaction may require a Hart-Scott-Rodino filing. More important, depending on the nature of the companies and their industry, the cognizant antitrust agency will need to clear the transaction. Waiting to the last minute to address the latter issue at least, adds a level of uncertainty to the transaction. It would not be a good thing if the parties spent millions of dollars and countless management time putting a deal in place only to find out that the government is not going to clear the transaction. Thus, an antitrust analysis may need to be done early in the transaction, if only to identify the risk of not getting a clearance and options [e.g., divestitures] which may be necessary to satisfy the government. Experienced M&A lawyers probably don't need a checklist early in the transaction to identify all the issues, although personally, I doubt this. Less experienced deal lawyers are another story altogether. In any event, early planning for an M&A transaction is critical.

Equity Security - The only pure corporate equity [i.e., ownership] security is common stock. It is a claim on the cash flow and assets of a corporation which is accompanied by voting rights. The bad news is that in liquidation, common shareholders generally take towards the bottom, where little or nothing is left. By way of contrast, holders of debt securities [e.g., bonds] have no voting rights, but they are close to the top when a forced distribution is underway. The distinction between debt and equity begins to blur with hybrid securities such as Preferred Stock and convertible debentures (debt which the holder may convert into shares). Issuing common or preferred shares to raise capital is known as equity financing.

ERISA - The short name for Employee Retirement Income Security Act, the federal law governing pensions and other employee benefits [e.g. ESOPS, 401K plans]. ERISA can result in large liabilities for underfunded pension plans for sponsoring companies. These liabilities are an important concern for bidders/buyers in evaluating target companies, which means it is an important item for due diligence and can create **Successor Liability** issues in asset transactions despite the buyer's efforts to avoid them. Also, large underfunded pension plans can operate as a takeover defense, especially in the merger context, although obviously it is the rare target that intentionally underfunds its pension plans for this purpose.

ESOP - An abbreviation for Employee Stock Ownership Plan, a type of employee benefit plan sometimes also used as a takeover defense by placing (some) control over company stock in the hands of employees, who ostensibly will support management on the assumption that they value their jobs more than their ESOP stock increasing in price.

Exchanges - The New York Stock Exchange and the NSADAQs of the world. Physical places, including virtual places [e.g., NASDAQ], where securities are publically traded for companies that have joined the national exchanges and shares are registered with the SEC. Exchanges are nothing more than highly regulated places where investors can buy and sell securities in a reasonably controlled and rationale setting. In other words, national exchanges facilitate the buying and selling of securities [liquidity] which is of critical importance to investors. For purposes of this course, the national exchanges generally have rules and procedures that their members must comply with, some of which apply to M&A transactions including when shareholders get a vote on a transaction that may trump certain state corporation statutes in this regard. Securities are traded on other less efficient exchanges such as the Over-the-Counter Market [three OTCs] and so-called Dark Pools.

Exchange offer - An offer where securities (sometimes together with cash) are offered in exchange for the target's securities as the purchase price. As discussed, this is an area where the target may want to perform some due diligence on the bidder to ascertain whether the bidder's share price has real value. Relying on the trading price, for example, can be misleading because the market price does not always reflect the true value of the *Issuer*.

Exchange ratio - The ratio at which the acquiror's stock is exchanged for the target's stock in a stock-for-stock transaction [e.g., merger]. See the Pfizer/Pharmacia discussion in the text for an example of how this works in practice.

Exclusive - A binding agreement ["exclusivity agreement"] whereby the target gives a potential bidder a limited period of time to do or complete due diligence and negotiate a definitive agreement without soliciting or talking to other bidders. A sixty day exclusivity provision is generally considered reasonable by the courts. A variation of exclusivity is a No Shop clause in a definitive agreement which precludes the target from shopping the company to other potential bidders prior to the closing. This provision does not, however, preclude the target from entertaining any such bids if they are unsolicited. In any event, boards need to be careful about agreeing to exclusivity type provisions if it means that bidders who would pay more for the target's share get shut out of the process. For example, once a board's **Revlon Duty** is triggered, the board is obligated to get not only a fair price for the shares, but the reasonably best available price. If an exclusivity type provision impedes the latter from occurring by excluding other bidders who might pay more for the company, directors run the risk of breaching their fiduciary duty to the shareholders which may open them up to being sued in their individual capacity.

Exculpation of Directors - Provision in the articles of incorporation which relieves directors of personal liability for actions arising from their board responsibilities. In effect, the shareholders give up their right to sue directors for breach of their fiduciary duty of care, unless the director engages in intentional and knowing misconduct or self-dealing. See, e.g. DGCL Sec 102(b)(7) for Delaware's approach to exculpation. In Delaware, exculpation is only available in breach of duty cases and as the <u>Gantler</u> decision teaches, is not available to officers. Most states do not have such a provision. In Delaware, 102(b)(7) was enacted in response to the "infamous" <u>Van Gorkom</u> decision to provide directors with another measure of protection in limited, albeit important circumstances. You will see how section 102(b) (7) can work in director's favor when we get to the important <u>Lyondale Chemical Company</u> case.

Exhibits - Generally, side letters, agreements and other documents [e.g., assignments, transition agreement, claims management agreement, IP licenses, escrow agreement] delivered at closing that become part of the documentation of the transaction along with the definitive agreement and **Schedules.** Junior M&A lawyers can be expected to spend a great deal of time on exhibits and schedules, the latter being especially important because they can relate directly to **Representations** and **Warranties and Indemnification** provisions in the definitive agreement.

Fair - Term used to describe an offered purchase price which the target's board determines to be fair value for the company. For example, for a board to accept a bid for the entire company the offering price must be fair. The financial advisor, whether internal or external, such as an **Investment Banker**, will provide an opinion that the share price is fair to the shareholders ["**Fairness Opinion**"]. Basically, the opinion states that the transaction is fair to the shareholders from a "financial point of view." In other words, the share purchase price, often expressed in a range, reasonably approximates the **Intrinsic or True Value** of the company. Intrinsic value and the price at which the company's share trade on a national exchange are not necessarily the same thing. Indeed, the price at which a company's shares trade may not reflect the company's actual value. The later is a function of the market's collective assessment of the price at which the shares should trade based on the flow of information to the market and other factors. Determining the intrinsic or true value of the target is the product of a considerably more fact intensive, analytical undertaking that includes a thorough evaluation of the target financial and operation performance, current and future and a myriad of other factors. Investment bankers surely will look at the trading price of the target's shares including historical trading performance, but this is only one data point they will consider in arriving at their fairness opinion.

The ultimate decision concerning whether to approve the transaction including the sale price remains with the board which means that relying solely on the advice of a financial advisor is high risk. Consider fairness opinions to be a tool, some would say "belt and suspenders," that boards seriously consider and factor into their overall deliberative process. Indeed, there is no legal requirement that a board obtain a fairness opinion. Critics of fairness opinions argue they are inherently subjective, based on questionable assumptions and present a conflict of interest, and thus, are unreliable. Other critics see fairness opinions as nothing more than cover for the board's determination to accept the bidder's offer. In any event, fairness opinions are standard in the M&A world today for substantial transactions, especially those involving the sale of publically traded shares. See the Van Gorkam case for where this all started. See also, appendix G in the text for sample fairness opinions issued by prominent investment banking firms.

Federal Preemption - A constitutional doctrine that federal law is supreme to state law on subjects where both the federal government and the states have the constitutional right to make laws and the existing laws conflict. For this course, this doctrine is important in determining whether a state anti-takeover statute is unconstitutional, that is, interferes with a **Tender Offer** which is governed by the **William's Act**. Also, if securities are being used as consideration for the transaction, as long as they are "covered securities," the states may not regulate the offering, although registration and fees may be required in those states were the offering is made. See section 18 of the Securities Exchange Act which identifies covered securities.

Federal Securities Laws - The vast array of federal statutes and myriad of SEC rules and regulations, releases and the like constitute federal securities law. The primary statutes for M&A purposes are the Securities Act of 1933 and the Securities Exchange Act of 1934 and applicable SEC rules and regulations there under, which have the force of law. The federal securities laws can have important implications for M&A transactions, especially when **Reporting Companies** are involved or securities are being issued as all or part of the transaction. For example, in the case of acquisitions involving reporting companies, the federal proxy rules apply. The '33 Act registration requirements apply when the bidder proposes to issue its stock to acquire the target, unless the security or transaction is exempt. The **Williams Act** requires detailed reporting and disclosure filings when a public company goes private or a tender offer is in the works. And, Rule 10b-5, which was promulgated by the SEC under section 10(b) of the '34 Act, looms whenever a security is involved in a transaction. We have just scratched the surface, but the obvious point is that the deal lawyer in an M&A transaction must consider the potential application of the federal securities laws and possibly state equivalents as well. On the latter point, state "Blue Sky Laws," regulate securities and related matters. As the discussion immediately above reveals, if covered securities are involved in an M&A transaction, the states may not regulate any offering, although registration and filing fees may be required. In any event, the potential impact of relevant state Blue Sky Laws needs to be on the deal lawyer's checklist if securities are involved in the transaction.

Federal Trade Commission - One of the two government agencies that review business combinations involving non-banking institutions for antitrust purposes. The other is the Antitrust Division of the Department of Justice. It is beyond the scope of this course to explain what criteria determine which agency will take the lead role. As a general proposition, however, if either agency has experience with the parties to a transaction, this can be the controlling criteria.

In any event, the first step in the government's evaluation of a transaction from an antitrust perspective, irrespective of which is the cognizant agency, is **a Hart-Scott-Rodino [HSR]** filing [Request 1 and perhaps 2] which contains reams of information from which the FTC or DOJ can determine, along with other factors or information, whether the proposed business combination would violate the antitrust laws. Obviously, depending upon the nature of the companies involved [e.g., operate in the same or nearly same market], antitrust concerns may complicate or even doom a transaction. For example, if either the FTC or DOJ does not "clear" the transaction. As previously mentioned, the classic case was when Sirius and XM satellite radio companies decided to merge. Ultimately, the FTC determined that the merger did not violate the antitrust laws but not without both sides of the transaction spending lots of time and money marshalling the case that there were no antitrust issues. What this should tell you is that if your client is thinking about merging with another company, especially if it is in the same or similar industry, it would be wise to address potential antitrust issues early before committing itself to the transaction. Because antitrust law is highly specialized, many companies, even those with in-house legal departments, will hire an outside antitrust expert if the transaction presents potentially significant antitrust issues. In any event, the entire antitrust area may be one more thing the deal lawyer needs to add to his or her transaction checklist.

Fiduciary Out- A provision in a merger agreement which allows the target's board to terminate the agreement if a better deal for the shareholders presents itself. It is actually more complicated than this but the idea is that under the board's **Revlon Duty** to obtain the highest reasonably attainable value [not always price] for the company once it is up for sale or otherwise "**In Play**," the board has no choice but to accept a bid of higher value if it arises post execution of the merger agreement, but obviously before the closing. Without such a fiduciary out provision, its ability to terminate the agreement is seriously limited. In other words, unless it can find some other legal basis for terminating the transaction, the board has to go through with the deal and faces shareholder litigation for breaching its **Revlon** duty.

This provision amply illustrates the tension between competing client objectives. The bidder has spent a lot of time and money on the transaction, not to mention concluded that the deal is critical to its future growth and thus wants certainty that it will close. Often it will insert a "**No Shop**" provision in the agreement to discourage the target from seeking higher bids. The target's board is all for closing the deal with the bidder, but **Revlon** requires it to be open to legitimate higher bids that arise after the agreement has been executed. Failure to accept such a bid would expose the directors to personal liability and the very real prospect of injunctive relief if the shareholders learn that a higher bid is out there before the deal closes. To protect itself from personal liability and not be in breach of the agreement, the target's board will insert a fiduciary out provision in the agreement. To further protect itself from such a contingency, the bidder may require a sizeable termination fee. Not surprisingly, like many important provisions in a merger agreement, fiduciary out provisions can be the subject of intense negotiations with the bidder attempting to provide language which narrows the provision and the target's board looking for maximum flexibility.

Financial Statements –Balance sheets, profits and loss statements, income statements and the like which are the backbone to understanding the financial and operational performance of a company, and thus an important item on the due diligence checklist for acquirors, and even targets when the bidder proposes a stock exchange. In the U.S., most substantial companies' financial statements are prepared in accordance with **GAAP** [required for reporting companies under section 13 of the Securities Exchange Act of 1934]. Indeed, because GAAP is the common language of accounting, this facilitates business combinations by allowing for an "apples to apples" comparison or analysis of financial data. Because financial statements are important for M&A transactions, in addition to being an important due diligence item, they often are the subject of intense negotiations in terms of the target or seller's **Representations and Warranties** concerning their accuracy and completeness. This explains why the deal team for many transactions includes internal and external accounting experts. Someone has to be able to test and assess their accuracy of the target's financial statements. For transactions involving **Reporting Companies**, a lot of this work can be done before formal due diligence through the financial information provided in periodic reports which are publically available.

Forward triangular merger - A **triangular merger** in which the target corporation merges into a subsidiary of the acquiror (generally a special purpose shell corporation, e.g., MX Acquisitions, Inc., otherwise known as an acquisition vehicle). The subsidiary of the acquiror is the surviving corporation and the target disappears. Because the target is not the surviving corporation, many contracts, licenses, etc. will require consents to be obtained. To complicate matters, we also have the **reverse triangular merger**.

Friendly transaction - The opposite of a hostile takeover. For reasons we will discuss in the course, successful hostile takeovers are relatively rare these days and when they are commenced, they often end up in friendly or negotiated mergers or tender offers.

Generally accepted accounting principles [GAAP] - Accounting principles adopted by the accounting profession (Federal Accounting Standards Board [FASB]), which govern the preparation of financial documents such as balance sheets and profit and loss statements. Think of GAAP as the common language of U.S. accounting which is designed to bring order, consistency and reliability to the preparation of financial documents. It is the rare **Purchase and Sale Agreement,** at least for substantial transactions, that doesn't contain some kind of provision aimed at the seller representing that its financial documents have been prepared according to GAAP. Why? This is further indicia of reliability, which is obviously important to bidders. If the financials are inaccurate, the valuation process will suffer. Public companies are required by law to prepare their books and records in accordance with GAAP in part so investors can have increased assurance that the financial statements are reliable, and thus a sound basis for making an investment decision. In any event, while the buyer will want some assurance that the seller has used GAAP, it is the foolish buyer who doesn't do extensive due diligence of the target or seller's books and records. The international equivalent of GAAP is the International Financial Reporting Standards [IFRS] issued by the International Accounting Standards Board [ISAB] headquartered in London. IFRS is the predominate GAAP in most countries outside the U.S. The purpose is the same as GAAP, but the provisions can differ in important ways. For example, the disclosure requirements for material litigation under IFRS are broader than under GAAP, no doubt because most countries outside the U.S. have a less punishing civil justice system, but this is a subject for another time and place.

Going Private Transaction - A public company decides to delist from an Exchange for any number of reasons including frustration with its stock price, the SEC, or Sarbanes-Oxley rules and requirements [such as disclosure, auditing, executive compensation disclosure and now, comparability of CEO salaries to the salaries of workers, each or all of which can be very costly], or not wanting to deal with shareholder rights issues; sometimes all of the foregoing. Another, generally unstated reason is that the transaction will create a market for the insiders' shares which otherwise doesn't exist. One of the benefits of such transactions is that the new owners can engage in long term planning without having to worry about satisfying public shareholders' lust for quarter to quarter results. **MBO**s are common in going private transactions and generally involve extensive private equity participation, which often results in the **NEWCO** being "flipped," that is, sold to a strategic buyer or going public after the newly formed company is structured. The **SEC** has special disclosure rules (contained in Rule 13e-3) for these transactions, thus they are often called 13e-3 transactions. We will address going private transactions in the course, because they are an important M&A transaction. Finally, generally, the private equity firms which provide the bulk of the cash and financing for the transaction will obtain control of the board of the NEWCO to protect its investment.

Golden Parachute - An employment contract for an executive that provides benefits if there is a change in control of the company, or the executive's employment is actually or constructively terminated. Golden parachutes can be very lucrative but usually are not a takeover defense because they do not cost the buyer enough to be a significant economic deterrent. In fact, they may be an important factor in helping to mitigate managers' natural inclination to resist a takeover depending on the circumstances, which presents duty of loyalty concerns. Public companies are required to disclose these devices in their public flings [10Ks, & 10Qs]. This is another area which has the eye of the shareholders rights movement.

Greenmail - If not invented by, certainly popularized by the legendary "corporate raider" T. Boone Pickens in the go-go M&A 1980s. T. Boone would acquire shares of a company to the point that the company's board would get nervous that a takeover was imminent, or he would even commence the process. To avoid the possibility of a hostile takeover or even a change in senior management, the target company would turn around and attempt to acquire these shares at a premium price [Greenmail] and the "Greenmailer" would walk away with a nice profit. Understandably, Greenmail is highly controversial and has somewhat fallen out of favor in recent years, but it still occurs on occasion. In the movie "Wall Street," Terrance Stamp's character uttered the memorable line to Gordon Gecko [Michael Douglas] who bought a heavy stake in a company [Endicott Steel] Stamp was looking to acquire forcing him to buy the shares back from Gecko at an inflated price: " Gecko, you are nothing but a two-bit green mailer."

Actually, Gecko was worse than this because he went to jail at the end of the movie for **Insider Trading.**

Growth - The central goal which should drive M&A transactions. Simply defined, growth generally is measured by increased revenues or reduced costs or both and ultimately increased profits or earnings. Rational CEOs want their companies to generate as much profit as possible. Profits, especially the prospect of future profits or growth, theoretically, at least, drive the share price for public companies. Growth can be achieved in basic ways: organic growth through operations [e.g., making and selling products or providing services that generate acceptable profits] or acquisitive growth, that is, acquiring another company or some of its assets with the prospect that the acquisition will result in greater growth for the acquiror. A company's business strategy can include both organic and acquisitive growth. This is foundational to the subject of M&A. M&A is a business strategy for many companies. Think about our business jets scenario, and you will begin to get the picture. Company A wants to sell more business jets because this will generate more growth. So far, it has been hamstrung in its efforts to significantly differentiate itself from its competitors. If it were able to develop on its own, through it operations [organic growth], lightweight composite material for its business jets, it would sell more jets, presumably at acceptable profit margins. But it can't. So, it is eyeing the acquisition of Company B to obtain what it can't do organically. Sure, it can consider a license or a joint venture or even continue its own research and development. But there are certain disadvantages associated with these strategies. Weighing all the factors—which will become clearer as we move through the course—the CEO and the board have determined that acquiring 100% of Company B, even though not without risk, is the best growth strategy. At this point, as discussed previously, the company has embarked on an M&A transaction which if successful, will end with the acquisition of Company B and most importantly, result in increased business jet sales and profits and hence, greater growth. See Economic Value Proposition.

One final point, growth for the sake of growth can be a poor M&A strategy if the acquiror has not engaged in a disciplined analytical process for assessing how the acquired company or assets will actually achieve growth targets. As previously discussed, almost half of all public company mergers fail, and the primary reason appears to be that the acquired company did not contribute to growth, or in some cases, actually resulted in "negative growth." Getting deals right is not easy. This is why they take time and discipline.

Hart-Scott-Rodino [HSR] Filing - Notice filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. The first filing [Request] is triggered when certain transaction values or person thresholds are met. In other words, an HSR filing is not contingent on whether the business combination presents a potential antitrust issue. The First Request is relatively benign, at least when compared to a Second Request. If a Second Request is required, the quantum and type of information that needs to be provided is significant. Second Requests make the parties nervous for obvious, reasons not the least of which is that it means the FTC or DOJ is taking a closer look at the transaction from an antitrust perspective which can lead to an investigation or even the deal not being cleared. Indeed, on occasion one or both of the parties will create documents before and after the transaction that make life difficult for them. For example: The bidder's strategy department creates a pie chart for senior management labeled "Market Share with Acquisition" which includes a diagram showing the bidder will go from 20%

to 40%. Scribbled on the side of the slide provided to the DOJ is a note that says: "We will dominate." Perhaps an exaggeration, but you get the point.

The statute contains a thirty day waiting period, in other words, the deal may not close while the filings are being reviewed, although early termination is possible. Let's sum up HSR this way: if the deal meets the statutory threshold requirements, the initial filing at least is required irrespective of whether there are any antitrust issues. In any event, these filings can be costly and can delay the transaction, or even led to opposition by the government, which means that depending on the transaction the deal lawyer needs to be thinking about HSR early and plan for it.

Hell-or-High-Water Covenant - Provisions that obligates the acquiror to consummate the transaction, even if the target company is damaged or unable to satisfy certain Closing Conditions. It is a type of Best Efforts Clause, often seen in the provisions relating the acquiror's obligations in the context of obtaining regulatory or antitrust approvals. For example, a "pure" Hell-or-High-Water Covenant in the context of a transaction facing significant antitrust hurdles might require the Acquiror to complete the transaction and pay the target company's Shareholders, even if the Acquiror had to divest most of the target's assets in order to obtain antitrust approval.

Highly Leveraged Transaction - Transaction where the purchase price consists of significant debt [bank financing] and little equity [cash]. Another term for a leveraged buy-out. Private equity led transactions are generally highly leveraged. Low borrowing costs makes this capital raising vehicle highly attractive, especially if the acquired company has substantial cash flow to service the debt or is sold or flipped before the principal is due.

Horizontal Merger - A business combination of firms in the same industry who operate similar businesses. Go back to our scenario: Company A wants to acquire one of its competitors, another manufacturer of business jets. Horizontal merger. By definition, companies engaging in a horizontal merger face greater risk of anti-trust risks. Contrast a horizontal merger with a **Vertical Merger** where a company seeks to acquire a company in its supply chain-say the freight hauler for its products. This could still raise antitrust issues as well, but they generally present less of a risk. Contrast both with a conglomerate merger which presents almost no anti-trust risk, if the buyer acquires a dissimilar business. But note that if one of the conglomerate's businesses (e.g. division) acquires a company in the same industry, this could present anti-trust risks. As stated previously, irrespective of whether it is a horizontal, vertical or conglomerate "merger," an **HSR** filing may be required if the transaction exceeds certain thresholds.

Hostile Bid - An effort to gain control of a target company that has not been agreed to by the target's board, usually through a **Tender Offer** or an unsolicited proposal to the board. The 1980's marked the hay day of hostile takeovers. Today, they are less prevalent for a number of reasons, including state antitakeover laws and acceptance of defensive measures such as the poison pill and staggered boards. Ironically, the prospect of a hostile takeover can incentivize management to keep the stock price up which may make the deal too expensive. Thus, proponents of hostile takeovers would say they are good for the shareholders, either by forcing poor performing companies to get their act together or when executed, providing the shareholders with a **Premium** on their share price. Of course, boards and senior management may not see it this way, because often they will lose their jobs if the takeover is successful, golden parachutes, assuming they exist aside. People in power in corporate America tend not to want to lose power. In the final analysis, as previously discussed, hostile takeovers can still succeed despite the high hurdles they face, especially if the bidder offers a price that the target's board can no longer say no to.

In Play - A corporation is "in play" when a sale, change of control or break up is likely or inevitable, which is not always obvious. Generally, the board must take some affirmative step towards the foregoing such as opening up meaningful discussions with a bidder or resolve to move in another direction which could lead to a change of control or break up. However, the mere fact that a bidder approaches a target with a merger or even commences a **Tender Offer** does not mean the company is in play. The target's board generally needs to take some affirmative step towards a transaction that involves a change of control. This can be seen quite nicely in the Lyondel Chemical case, which we will spend time on in the course. Once a Delaware corporation is in play its board is subject to the **Revlon Duty** to obtain the highest reasonably attainable price for its shares.

Inadequate - Used to describe an offer or a bid which the target believes to be less than could otherwise be received from other bidders, or does not adequately reflect the value of the company. Just because a bid is inadequate doesn't necessarily mean that it is not fair. For example, in an auction context there may be two bids which are fair-that is, within the range of fair value for the company, but one bid is a $1 higher than the other; the lesser bid is fair but inadequate.

Indemnification [Contractual] - Provisions in a definitive agreement giving one party post-closing claims against the other for breach of the other's representations/warranties and covenants that **Survive** the closing. Also, indemnification can arise from a specific provision in the agreement where the seller agrees to indemnify the buyer for certain products liability losses, irrespective of a rep and warranty. For example, seller agrees to indemnify the buyer from any products liability losses arising from any products sold prior to closing. Let's call this "direct" indemnification. Indemnification is especially relevant to asset transactions because reps and warranties do not survive a merger. As discussed previously, indemnification provisions can include a basket, deductible or a cap to limit the financial exposure of the party providing the indemnification. Depending upon the nature of the transaction, the parties and their lawyers will spend considerable time negotiating indemnification provisions in the definitive agreement. Think about it: Company A pays $500M for Company B's lawn mower division. It's more than they wanted to pay, but they negotiate an indemnification agreement to cover products liability losses arising for products sold prior to the closing. Thus, their investment will be protected by the seller's indemnification to the extent there are any product losses. Of course, and cement this in your brain because many often forget this [and no one tells you this in law school], indemnification is only as good as the assets which back it up, and if there is a dispute over the indemnity obligations, it can lead to costly litigation with uncertain results, not to mention attorneys' fees which rarely are recovered. Sorting this out ahead of time for the client is what lawyers get paid for. Therefore, it is not unusual to see an indemnification obligation backed up with an escrow agreement. Also, the insurance market has come up with an interesting product to facilitate transactions where either side has a problem with the size of indemnification—Representation & Warranty [R&W] insurance.

Indemnification [Corporate] of Directors and Officers - State corporation laws generally permit corporations to indemnify directors against liabilities and expenses of litigation, arising from their duties. Delaware has the most expansive indemnification provision which is yet another reason companies incorporate there. Indemnification does not cover every act by a director, however. For example, under the relevant DGCL provision, corporate indemnification is not available when a director or officer acts in bad faith. Also, the SEC has placed certain limitations on what public companies can indemnify their directors for and certain acts under the state statutes are not subject to indemnification [e.g., intentional misconduct].

Most directors, especially those of large public companies, are intensely interested in the company's D&O insurance and corporate indemnification provisions, which are generally contained in the by-laws. This is not an insurance course, but suffice it to say, these devices complement themselves, which means they are rarely substitutes for each other.

Independent Director - Not precisely the SEC definition, but for purposes of this course, a director of a corporation who is not an officer or employee of the corporation and has no material personal stake in the transaction under consideration, or at least the interest is not controlling. **Special Committees** consist entirely of independent directors to lessen conflict of interest concerns, which is a common basis for shareholder M&A related litigation. The NYSE requires that its members have a majority of independent directors on their boards. The fact that a director is not an employee of the company doesn't necessarily mean he or she is truly independent, given how directors are selected, their personal or social relationship with the CEO and their compensation and perks. The courts tend to accept this as a fact of life when faced with conflict of interest allegations. So long as the directors otherwise act responsibly in their deliberative process, the courts tend not to find such factors controlling. Of course, unhappy shareholders don't always see it this way which is yet another reason we have endless M&A litigation.

Injunction - An equitable remedy which may be used by shareholders, for example, to block an M&A transaction they are unhappy with. The standards for preliminary injunctive relief are high (e.g., irreparable harm, balanced against the harm to the defendant and reasonable likelihood of success on the merits). Nevertheless, this is a potentially powerful weapon unhappy shareholders have available to them. While we are at it, shareholders have three basic remedies when faced with an M&A transaction they are unhappy with: (1) damages, either through a breach of fiduciary duty claim or appraisal rights, the later depending on the nature of the transaction; (2) injunctive relief; and (3) rescission, although the latter is generally not available because it is almost impossible to unwind transactions that close. Of course, depending on the circumstances, they may have an action for civil fraud under the federal securities laws.

Insider Trading - The '34 Securities Act [section 10(b) and subsequent rules [primarily 10b-5] promulgated by the SEC establish severe administrative, civil and criminal penalties for those who trade [buy or sell] securities while in possession of material non-public in breach of a duty of confidentiality. The doctrine is more complex than this but you should get the point for M&A purposes. Insider trading ranks right up there on the SEC's list of most hated activities, and they have no trouble finding numerous cases to prosecute annually, although recently they have suffered some important setbacks. Public company M&A transactions present the potential for insider trading violations by participants in the transaction which is why confidentiality and prohibitions against non-protected [e.g., trading plans] trading activity by insiders are an important part of the deal lawyer's transaction checklist. This can be a challenge because the longer the deal goes on before it is announced publically [then it is okay to trade on the information], the larger the pool of internal and external people who know about the deal. Of course, both parties to a public transaction at least have the greater concern that if word concerning the transaction gets out before they are ready to announce it, the price of the target can go up [think arbitragers] and other suitors may emerge once they know the target is in play, not to mention employee angst which can lead to productivity problems.

Institutional Investor - A large professional investor that invests money it holds as a fiduciary in stocks, bonds and other securities. Important examples are pension funds, hedge funds, insurance companies and mutual funds. The majority of securities, especially stock, are held by institutional investors who because of their size, financial strength and other capabilities [e.g., program trading] have a huge advantage over individual or **Retail Investors** when it comes to trading activities. Not surprisingly, depending on the size of their stake in a particular company, institutional investors can influence M&A transactions. Interestingly, they are often chary about leading **Shareholder Class Actions**, will sit in the side lines before jumping in, and often will opt out. Indications are that in recent years this reluctance is waning.

Insurance - An important loss reduction [risk management] tool for the insured, that is, who "owns" the policy, and thus a frequently important item on due diligence checklists. Potentially covers all types of losses, subject to deductibles or retentions and limits, ranging from products liability, patent infringement claims, Director and Officers liability, property loss, environmental claims, etc. Insurance is considered to be an asset for accounting purposes, and thus, the transfer of insurance is spelled out in the definitive agreement. For asset transactions in particular, the critical question often is whether the policies will go (assignable) to the buyer. The language in a policy may govern. If not, the case law is all over the lot on assignability. If your client is the buyer, it will want to know whether it will own the insurance policies that cover any insurable losses they assume. While we are at it, they also will want to know the scope of the coverage, e.g., deductibles or retentions, limits, exclusions-before a definitive agreement is executed.

Integration - The next to last phase on the **M&A Timeline/Process chart**. Another often overlooked but critical aspect of a transaction. This is the process post-closing where the buyer integrates the acquired company or division into its operations. If not done right, this can spell trouble for the ultimate success of the transaction, which is why sophisticated companies like IBM think about integration early in the M&A process. If steps are taken towards integration before the closing, this can create anti-trust problems. For complex transactions, the buyer often will establish early in the due diligence process an integration team staffed by key functional areas which prepares an integration plan to ensure a smooth transition. For example, if the two companies have different payroll processing programs, efficiency would dictate that there be one system. Integrating these two systems could be costly and time consuming, possibly impacting the value of the deal. Other important examples include accounting systems, manufacturing operations and distributor networks, to name a few. See also culture above for a further illustration of why integration is important. If the literature is to be believed, most public company mergers that fail do so because the bidder has not done a good enough job with the economic valuation proposition. The second most important failure mode is lack of effective integration.

Internal Affairs Doctrine - Choice of law and due process principle that determines which state's law governs the corporate formalities requirements that must be satisfied in order to validly consummate a particular M&A transaction, as well as other internal affairs of the corporation. See Maynard, pp. 143-151, including the leading U.S. Supreme Court case on the subject. Basically stated, the law of the state where the company is incorporated governs the internal affairs of the corporation which includes acquisitions. A companion doctrine adopted by the Delaware courts is the "independent legal significance" doctrine which basically provides that if a transaction meets the criteria of one corporation law statute, it can rely on that statute even if the transaction could have been structured in accordance with another DGCL statute. These two doctrines are of critical importance when considering M&A transactions.

Internal Controls - Generally understood as formal accounting/financial compliance procedures, designed to ensure the integrity of an entity's financial accounting and reporting. See, e.g., **Foreign Corrupt Practices Act** amendment to section 13 of the Securities Exchange Act of 1934, which is all about enhancing public companies' internal controls in an effort to ensure the integrity of their financial statements. In most corporations, the Controller's department is responsible for day-to-day management of the internal control processes. In other words, they don't just manage the nuts and bolts of accounting and bookkeeping. While we are at it, as previously discussed, U.S. companies follow Generally Accepted Accounting Practices [GAAP] in maintaining their financial books and records. Think of GAAP as a common language for accounting. The actual standards and rules for GAAP are promulgated by the Federal Accounting and Standards Board [FASB], a quasi-government agency. The purpose of GAAP and FASB is to establish reasonably uniform and reliable procedures for accounting and reporting. For example, FASB is a rule which governs how companies should report and set reserves for litigation, when the loss is "probable" and "estimable." This dovetails with the SEC disclosure rules concerning material losses which are required to be set out in the various public filing and periodic reports. See, e.g. Section 13(a) of the '34 Act. As you no doubt have figured out, there is ample room for interpretation and "creativity" in this and the myriad of other accounting and reporting areas under GAAP, the FASB rules and the disclosure rules, but remember that the SEC has oversight and enforcement power if mistakes are made. To complete the cycle of generally accepted accounting principles, there is another body that you need to be concerned with, and that is the International Accounting Standards Board [IASB]. This body issues accounting pronouncements called International Financial Reporting Standards [IFRS]. IFRS is the generally accepted accounting outside of the United States. There is an ongoing project between the IASB, the SEC and the FASB to create one worldwide set of accounting standards, and it is called the "convergence process." Ultimately, GAAP may disappear, and IFRS will be the dominant accounting standard throughout the world. As a litigator, this would not be a happy event if the current rules on disclosing material litigation or government proceedings under IFRS survive. The SEC would be happy, of course. And so would plaintiffs' lawyers who would have a rich source of information concerning reserves and the chance of successful defense currently unavailable to them under U.S. privilege law.

Inversion - See Taxes below.

Investment Banker - A very important stakeholder in many M&A transactions, especially those involving large public companies. The investment banker [e.g. Goldman Sachs, Merrill Lynch] is the financial advisor to a company or **Special Committee**. The target often retains an investment banker as well. In advising a bidder, the investment banker will opine on the desirability of the acquisition, its terms and structure and the strategy and tactics for implementation. The investment banker can also assist in arranging financing for the transaction, among many matters. Investment bankers often bring the deal itself to the buyer or bidder or identify potential buyers in an auction, for example. They are experts at drumming up business. The target's investment banker will generally advise the target's board concerning the strategy for dealing with bidders, and they will generally provide as previously discussed, formal written opinions as to the fairness of any offers ["Fairness Opinion"]. As previously discussed, investment bankers can generate huge fees in the form of fixed fees for their purely advisory services and transaction fees based on a formula agreed to by the parties, if the deal closes.

Issuer - With respect to securities, the company that has the right to offer or sell them. It's that simple, although issuing securities is not given the plethora (i.e., too many, not a lot which most people think the word means) of statutory, SEC and state rules and regulations. Example, if Textron wants to do a public offering to raise cash [that is, issue more shares or bonds to finance an acquisition]; it is the issuer of the security. The investment banker, broker-dealer, national stock exchange and SEC, all can play a role in the offering but they are not the issuer.

Junk bonds - Bonds and other debt securities that are not investment grade and pay high rates of interest to compensate for high risk. The King of Junk bonds in the go-go 80's was Michael Milken who made a fortune brokering takeovers and related transactions using junk bonds as the major financing vehicle. He also went to jail for massive insider trading among other actions. The market for junk bonds today remain uncertain, but they are still around and do turn up on occasion as part of the financing for transactions, especially two tier mergers.

Letter of Intent [LOI] - A letter generally outlining the key points in a transaction and signed well before the more detailed definitive agreement is ready. Its purpose is to establish milestones for the transaction as well as encourage the parties to complete due diligence, accelerate negotiations of the definitive agreement, etc. Consider the LOI to be a roadmap for completing the transaction. Often, the buyer will indicate a range for the purchase price, subject of course to many caveats. The target or seller will generally want to make the price as specific as possible on the theory that as the deal progresses it will lose leverage on price negotiations. A potential minefield if language isn't added to make it clear that the parties aren't agreeing to critical deal terms but merely setting forth their "intentions." Occasionally, the LOI will identify binding terms such as exclusivity for the bidder. In other words, it may or may not be a legally binding agreement, depending on its terms and the conduct of the parties. Think of an LOI as a platform that is generally honored by the parties. In any event, it can get tricky when something unanticipated occurs and great care should be taken to keep the deal moving forward but not commit to material terms, unless of course it is in your client's interest to lock in the other side on such terms. Letters of intent often pit the lawyers against the business people, because the former is afraid of saying anything that could even remotely be considered binding and the latter wants to encourage the other side to get the deal done so it may be inclined to be more generous in the language. Here in lies the rub for lawyers. Transactions are expensive propositions. Spending endless hours haggling over the letter of intent only drives up the costs for clients and adds to uncertainty. Achieving the right balance between facilitating the transaction and protecting the client can require both legal skills [e.g., drafting] and a willingness to take some risk.

Letter of Interest- Friendly letter sent by a bidder to a target company asking whether the latter is interested in a business combination. Obviously, it precedes an LOI on the **M&A Timeline**. Experienced companies generally have sized up the target company as a potential acquisition before sending the letter. **Investment Bankers** can be one source of such information.

Level Playing Field - A fair set of rules applicable to all bidders. In an auction, the term usually refers to rules established by sellers to deal with bidders set forth in the bid procedures letter; this is ironic, because bidders often disregard the bid procedures and still remain in the process, if their bid is attractive enough.

Leveraged Recapitalization - A transaction in which a company borrows a substantial amount of cash and pays the cash to shareholders by a dividend or a stock buy-back [self-tender]. This can be a very risky strategy because the financing is subject to interest rates [borrowing] which can fluctuate and depending on the size of the debt the company's future operations could suffer, spelling trouble for the share price. My experience with leveraged recapitalizations is in an auction setting, where the **Special Committee** used the prospect of a leveraged recapitalization to encourage a bidder to raise its price. In other words, if you don't raise the bid, we will pursue a leveraged recapitalization, because it shows greater value for the shareholders than your bid. Recapitalizations are risky propositions, especially if accompanied by a **Self-Tender** which in itself may implicate the **Federal Securities Laws.**

Leveraged Buyout [LBO] - Acquisition where a high percentage [70% + not unusual] of the purchase price is financed, that is borrowed, hence the term leveraged. In the go-go 80s, when hostile takeovers dominated the landscape, much of the financing was through junk bonds, giving new meaning to the term highly leveraged. You might ask yourself why an acquiror would leverage up to 80% of the purchase price. Very risky, right? Well, it depends. The seller doesn't care because generally it receives the purchase price in cash either directly or through purchase of the shares. All things being equal, they are done with the transaction. As to the buyer, they are only potentially out the equity [cash] they contributed. If the company has healthy cash flow and can be restructured to reduce costs generating even more cash, this presents a vehicle for servicing [paying off] the debt and potentially creating dividends or even eventual sale of the company at a nice profit. Also, the cost of the debt-interest can be low relative to the return on the investment [ROI], making the transaction even more attractive. Of course, highly leveraged transactions can easily fail and do, especially when the assumptions concerning how the acquired company will perform turn out to be wrong. Most private equity firm acquisitions are highly leveraged.

Lockup - An option on some of a takeover target's important assets (occasionally stock) given by the target to a favored bidder. The purpose is to discourage competing bids. Sometimes a lockup is used by a target's board to obtain a last higher bid. Lockups can be risky propositions for boards, if they are a significant deterrent to other bidders either alone or when considered together with a break-up fee or other deal protective devices. See **Revlon Duty**. Also, refers to time periods which limit insiders and others from selling their shares in an Initial **Public Offering** [IPO].

M&A Process/ Timeline ["Deal Flow"] - A multi-step process [often represented in a flow chart] which starts with the decision to actively evaluate and pursue a M&A transaction, and continues through the closing and integration of the seller, or some of its assets, into the buyer post-closing. You will be given a sample flow chart and will be expected to understand each important step in the process. Think of the time line as the road map for the transaction. Also, pay particular attention to what steps the lawyers heavily influence, those where they make a contribution and those where they have little or no role to play. Some companies—for example Textron Inc.—have highly detailed M&A protocols which are rigorously enforced. Other companies—for example Nortek Inc.—are less formal and rigid, being more concerned with getting the right deal done as quickly and inexpensively as possible. Both can be successful strategies or not. While related, the **Structure** of the deal is different from the process or timeline. The M&A process is relatively consistent from deal to deal for large-scale transactions; the **Structure** generally depends on the client's objectives. Obviously, selecting the structure is a step in the M&A process.

Main Street v Wall Street Deals- Because most important M&A law generally involves large, sophisticated companies and transactions, there is a tendency to lose sight of the fact that the fundamental propositions and basic legal principles of M&A apply to smaller, more mundane "Main Street" transactions which are the bread and butter of most lawyers practicing in this area. This applies even if the parties to the transaction are in highly regulated industries such as banking and telecommunications. For sure, not every step of the M&A process applies to every transaction; nor does every transaction raise securities law or other federal law issues. Having said this, the **Structure** for the transaction, client objectives, the fiduciary duties of boards and officers, due diligence, valuation and definitive agreements, to name some, are aspects of M&A which apply to almost every M&A transactions. Yes, depending on the nature of the transactions and financial strength of the parties, practical solutions and tradeoffs may need to be made. The important point here is that what you learn in this course should have application to most M&A transactions you will get involved with, irrespective of their size, value or industry the parties are part of. Many students seem to have difficulty grasping this concept. For example, if presented with a deal valued at $2M they often seem to be confused as to how to approach it. Well, someone is the buyer; someone is the seller, somebody has to determine the purchase price, someone has to decide on the structure-asset, merger or stock purchase; there are certain corporate formalities that may need to be satisfied; there has to be some due diligence; there needs to be a definitive agreement of some sort, etc. The details may be different than a large public company transaction but the basic prism from which to approach the transaction is not.

Management Presentation - Often the initial meeting between the buyer and the seller where senior management for the latter provides an overview of the company including high level financial information, market share, product or services performance, etc. If an investment banker is involved for either side, he or she is there and you can expect the seller's investment banker had a hand in the preparation of the presentation. One way to look at this process is it's the beginning of formal or legal due diligence and an opportunity for both sides to begin sizing up each other as well as the deal itself. Indeed, I am aware of several transactions involving sophisticated public companies where management presentations have confirmed concerns that potential buyers had, and even walked away from the transaction, although frankly this is rare because most sophisticated buyers looking at public companies have a good idea of the target already from public due diligence or industry knowledge or both and there is little to be learned from the presentation. I am aware of one management presentation where the CEO of the company in-play was so outraged that a competitor turned up as a bidder, that he dropped the F bomb twice in his introduction, bolted after five minutes and left his management team to fly home commercial. You can safely assume that this is an exception.

Market Check - When the target's board, generally with the assistance of an investment banker, conducts a search to see if there are any entities who are interested in bidding for the target. Generally, a market check is resorted to when the target is up for sale or a break up is considered, and the board wants to fulfill it **Revlon duty**, that is, demonstrate that it has made a reasonable effort to get the best reasonably attainable price for the company. As we will discuss in the course, market checks are not always necessary for the board to meet its **Revlon duty**, especially if the circumstances render the market check futile. For example, the price the bidder has offered is so strong that it is highly unlikely another viable bidder will emerge or the company has canvassed the market for several years and no one has expressed interest in bidding for it. In any event, conservative boards often will do a market check when the company is in-play in order to give plaintiffs' lawyers one less thing to seize on.

Market Out - A condition in a **Tender Offer** or a **Merger Agreement,** giving the bidder the right not to close in the event of material adverse changes in the financial or securities markets. For example, there is a collapse in the financial markets which makes the bidder's ability to raise financing prohibitively expensive. The bidder had nothing to do with this; so the market out clause would allow it to walk away from the deal without penalty. Not entirely the same as a **MAC** or **MAE**, but similar.

Material Adverse Change [MAC] or Event [MAE] - Narrowly defined, a condition to completion of a tender offer, a merger or even an asset deal, that there has been no material adverse change in the company's business or operations from the date the definitive agreement is signed to the closing. Bidders generally look for a broad MAC; targets or sellers generally want to narrow the clause to matters that they can control thus, they will seek several exclusions. If a MAC or MAE occurs, the transaction may generally be abandoned without penalty, although the condition can always be waived. MAC provisions are generally subject to heavy negotiations, because they provide a potential out for at least one of the parties, generally the bidder. Moreover, because of the potentially significant consequences as well as the inherent ambiguity of the term, they offer a basis for negotiations which can save the deal and probably explains why they generally are qualitative as opposed to quantitative. Bidders attempting to avail themselves of these provisions need to be wary of the fact, as Tyson Foods found out in the <u>IBR</u> case that we discuss, that Delaware courts in particular are loathe to letting bidders get out of intensively negotiated transactions and place the burden of proof on them. Why? The Delaware courts have a strong bias towards facilitating the closure of transactions that have been heavily negotiated. Indeed, until very recently is does not appear that the Delaware courts have ever allowed a bidder in a merger transaction to avail itself of a MAC or MAE clause.

Note: By this point, you are probably scratching your heads wondering how the parties determine what "material" is. Well, defining materiality in the definitive agreement is extremely difficult given the inherent imprecision of language, but it can be done, but generally is not which means one of at least two things happen when one side screams "material adverse change or material breach of a representation and warranty": the parties attempt to negotiate a resolution which could include an increase or decrease in the purchase price or some other monetary settlement depending on the circumstances, or they fail to reach agreement and the matter gets resolved by the courts, which generally results in less than an ideal outcome.

MBO - A management led buyout of a public company, often highly leveraged and often involving a private equity firm. Frequently, MBO's involve taking a public company private. Obviously, if management occupies any board positions, there is a conflict of interest generally resulting in the appointment of a **Special Committee** of independent directors to consider the proposal.

Merger - In a statutory merger [e.g., DGCL 251] two companies combine with one of the companies disappearing as a legal entity. By operation of law in most states, the surviving corporation is left with all of the assets and liabilities of the other, which means **Successor Liability** is generally moot [but see the PPG case in the text for an exception]. In a merger, shareholders usually receive cash or securities [occasionally both] of the survivor or its parent in exchange for their stock. Mergers generally require the approval of both boards and shareholders, generally a majority. Contrast a **Tender Offer** where the bidder makes the offer directly to the shareholders in an effort to avoid the board, on the assumption, implicit or explicit, that the board wants nothing to do with the takeover. But, isn't a tender offer an acquisition? A merger as well? Or is it only a precursor?

Importantly, many mergers entail two steps or tiers; that is, the bidder acquires a controlling interest in the target and then completes the merger with a second step. See DGCL 203 [short form merger-when parent owns 90% of the subsidiary] and recently enacted DGCL 251(h) [back end merger where the bidder has a majority of the voting shares and thus can take out the remaining minority shareholders because it controls the majority vote]. These are convenient devices to take out dissenting minority shareholders without the need for their approval, including the time and cost associated with the proxy process. Delaware law does provide, however, that minority shareholders are entitled to appraisal rights under both provisions and the Entire Fairness Test provides further protection for certain transactions.

Merger of Equals - Often a myth, but this is when two companies [e.g., Daimler-Benz & Chrysler], often of about the same size, agree to go forward as a new company **[NEWCO]**. The stock of both companies is surrendered, and the new company issues stock in its place. The shareholders' stock is converted to the stock of the new company, in the hope that the new company's growth will increase the share price. Also, generally the board of the new company is comprised of equal amounts of the predecessor boards. In reality, one of the companies ends up being dominant, and thus, there is little "equal" about the transaction from at least the senior managers' perspective. To make the deal more palatable and brunt some of the negative connotation of an acquisition [one company takes over another, is clearly in charge and the buyer's stock continues to be traded], the deal is referred to as a "merger of equals."

Minority Shareholders - When a single shareholder or organized group of shareholders has effective control of a corporation (generally measured by a majority of the voting power), the remaining shareholders are minority shareholders. It is a little more complex than just having less than a 50.1% ownership position. Minority shareholders do have rights; for example, appraisal rights if they don't like the price offered for their shares. They also can sue for an injunction or, depending on the circumstances, eschew their appraisal rights in favor of damages. **Squeeze out or freeze out mergers** tend to give minority shareholders fits and are a frequent basis for shareholder litigation, usually regarding challenges to the process used by the board to reach its decision and of course, to the price the controlling entity pays for the minority's shares.

NEWCO - Acronym for the new company which emerges after a merger. For example, A merges with B to form C—the NEWCO.

Negotiated Transaction - An acquisition or other transaction between companies in which both sides are willing participants. It is not unusual for hostile takeovers to end up as negotiated settlements, especially if the bidder eventually raises its price to the point where the target's board can't say no anymore or the board has no other place to go because its business plan is failing and no other person or company is interested in purchasing them.

No-Shop Provision - One of several "deal protection" devices; a provision in a definitive agreement that prohibits the target from searching for a better offer before the acquisition, generally a merger, is completed or the agreement is terminated. However, the target is not prohibited from negotiating with an unsolicited bidder. While we are at it, a No-Talk or Solicit provision prevents the target from actively talking with other bidders, which can present a problem under **Revlon.** These two provisions, and others [e.g., break up fees, lock ups, crown jewels and termination fees], if too onerous can cause problems for boards of public companies complying with their fiduciary duties when their company is up for sale. See **Revlon Duty.** Why? Because they can preclude the shareholders from getting the best reasonably attainable price for their shares, as other potentially better offers are effectively discouraged. Thus, any deal protection device must be evaluated within the total fact pattern to determine if it is unfair from the shareholders' perspective. Today, many public companies will insert a "Go Shop" provision [which has a Go Shop period] into a merger agreement, allowing it to seek out competing offers even after it has received a firm purchase offer. This is generally accompanied by a "fiduciary out" provision which permits the target board to back out of the deal if a better offer comes in during the Go Shop period. Deal protection devices are a variation of takeover defenses subject to the <u>Unocal</u> standard.

Officers - The corporate officers of a corporation are generally elected annually by the board and are often the people who actually run the company and may even "control" the board, especially when the CEO is the Chairmen. The relationship between the board and the CEO in an M&A transaction can be perilous, particularly if the CEO is anxious to do a deal and commits the company to it without obtaining the board's approval. What is the board supposed to do then, especially if it is a material transaction which requires board approval? Many boards loosen the reins a bit by allowing the CEO to pursue deals below a certain dollar threshold without the board's approval. For example, Textron may allow the CEO to make an acquisition for $25M or less without Board approval, provided the Board is kept informed. You need to look to the relevant state's statutes, articles and by-laws as well as the delegation of authority to sort this out. See, e.g., DGCL §142. Under Delaware law, officers are not eligible for exculpation, unlike directors. See the <u>Gantler</u> case for this proposition, among others important for this course.

Pac Man Defense - Defensive tactic in which the target corporation, subject to a hostile bid, seeks to acquire the bidder. You don't see this tactic too much these days. The most recent example of this defense at work is the Men's Warehouse/Jos. A. Banks merger, which may or may not be completed by the time this course starts.

Poison Pill - Very powerful antitakeover mechanism, which along with staggered boards and antitakeover statutes [e.g. DGCL 203], has largely killed hostile takeovers in some commentators minds. A generic term used to cover (i) any device or action that has (or threatens to have) a negative impact on both a third party and on the person adopting the device or action and (ii) any device that has an antitakeover effect, particularly if adopted by a target. The central feature of a **Shareholder Rights Plan**, the prototypical poison pill, is that it makes a takeover prohibitively expensive for the bidder. In other words, a poison pill is a defensive measure that is often used by boards to fend off hostile takeovers. Certain poison pills require approval by the board and ultimate approval by the shareholders. The Unocal case establishes the "proportionality" test for when defensive measures such as the poison pill are reasonable. Keep in mind that when the target is subject to a hostile takeover, assuming informed and good faith deliberation by the board, the board is not required under Delaware law to accept the bid simply because it was made. In fact, it has an affirmative duty to take measures to protect the company from a hostile takeover; hence, defensive measures such as poison pills may be reasonable. Why? Because the board has a fiduciary duty to protect the corporation as well as the shareholders, whereas, once the company is up for sale, the board's sole responsibility is to get the best reasonably attainable value for the shareholders. [This is the lesson from **Revlon**, at least in Delaware and absent any constituency statute.]

Post-Closing Checklist - For complex transactions, many activities need to be accomplished post-closing by both sides, especially the buyer. For example, the definitive agreement may contain indemnification provisions that are triggered by certain events and dollar thresholds and other similar requirements and obligations on the part of the seller or even the buyer. Post-closing filings of one type or another may be required. You would be surprised how many times the parties lose track of these obligations or requirements, often resulting in money being lost. This is especially the case for companies that engage in frequent M&A activity. Sophisticated companies go through the definitive agreement, including schedules and exhibits, list the obligations and requirements and assign people to keep track of them. For example, the seller has agreed to indemnify the buyer from any products liability losses post-closure when the aggregate value of those losses exceeds $1M. The deal manager for the buyer [e.g., VP, M&A] will insert this on the post-closure checklist and assign someone, generally an in-house lawyer if one exists or someone in the M&A department, to be responsible for tracking the products losses and triggering indemnification when the threshold is met. I have been personally involved in a situation where the seller lost track of the buyer's post-acquisition obligations and for almost a year made payments that were the buyer's responsibility under the Purchase and Sale Agreement. It was a mess sorting this out.

Preemptive Bid or Offer - An offer that is so high it preempts other offers. Theoretically, the management team in an MBO may make an offer to purchase the company that is so high relative to the historic share price of the company and its value that there is no need to solicit other bidders. Or, an outside bidder makes such a high bid that it effectively discourages other bidders from appearing.

Preferred Stock - A hybrid security, still in common use, that has some characteristics of both an Equity Security (common shares) and a Debt Security (e.g., bonds or notes). It usually has a fixed dividend that must be paid before common stock dividends and, in liquidation, a claim that comes before common stock but after debt claims. Preferred Stock is usually callable by the issuer after a certain time in accordance with a contract schedule of prices. It may have general voting rights or may have a vote only in special situations. As with all hybrid securities, the characteristics of Preferred Stock may be varied to meet different circumstances. The rights of preferred shareholders, unlike common equity shareholders, are spelled out by contract.

Premium - Share price offered by the acquiror in excess of the publicly traded share price of the target corporation's stock, generally measured from the time immediately prior to public announcement of the acquiror's offer. In addition to offering a share price that will be attractive to the shareholders to gain their approval, the premium also reflects the fact that the shareholders who sell will no longer be able to avail themselves of the benefits of ownership. For example, Company A's stock is trading at $28 per share on August 30th. The MBO group offers to buy the Company for $31 per share on August 31st. Now, if they are successful in getting the company at that price, the premium is $3. It should be apparent by now that just because a premium is offered, this doesn't mean that the offered price represents fair value for the company. The fact that Company A's stock is trading at $28 does not mean that the true value of the company is $28 per share. All that the $28 dollar represents is the price the collective wisdom of the so-called efficient market has arrived at. Do not confuse **Valuation** for M&A purposes with the price at which a stock is trading.

Products liability - An important item on due diligence checklists for companies which make products that have the potential to cause personal harm, property damage or both. Whether strict-liability in tort, negligence or some other theory, manufacturers and those in the chain of distribution bear the costs associated with harm caused by their products. Certainly, insurance may defray some of these costs, which is why insurance for products liability losses is another item on a buyer's due diligence checklist; however, not all product harm may be covered by insurance, and if there is coverage, many policies have high retentions or deductibles. For many asset transactions involving manufacturing companies, losses attributable to products liability can be important factors in valuing a company, including whether or not to make the acquisition or at least how to address products liability risks in the definitive agreement.

Profit/Loss equation - Over-simplified, but a reasonable working definition is revenues [sales] minus costs and expenses equals profits. Thus, when considering an acquisition, the potential acquiror should be reviewing the transaction in terms of how it will ultimately increase its profits. In other words, will it grow the company? See economic value proposition.

Proxy - The form which issuers [e.g., public companies] provide to shareholders of public/reporting companies for voting purposes [e.g. election of directors, corporate resolutions, approval of mergers]; accompanied by a Proxy Statement explaining the matter at hand and providing extensive background and supporting information. Proxy statements are subject to the same stringent disclosure rules as public filings under the federal securities laws. See, Section 14 of the '34 Act and SEC rules and regulations thereunder. They must be accurate and comprehensive.

Public Company - Generally, a company whose stock is held by the "public," meaning a large number of holders and registered on an exchange [e.g., New York Stock Exchange; NASDAQ] and with the SEC under Section 12 of the Securities Exchange Act of 1934. See also section 15(d). Obviously, public companies, due to the business combinations they engage in, are subject to the labyrinth of federal securities laws, rules and regulations, including public reporting and proxy rules, not to mention the 10b-5 antifraud provision and Sarbanes-Oxley accounting and reporting requirements. As a result, transactions involving public companies have to factor in the federal securities laws and regulations which only add to the cost of such transactions, a problem which purely private transactions [provided a security is not involved] do not have to worry about. See **Reporting Company,** which includes private companies as well public companies, provided the former meet certain threshold requirements set forth in sec 12(g) of the '34 Act.

Purchase & Sale Agreement [PSA] - As discussed previously, the definitive agreement for an asset acquisition, not to be confused with a merger agreement but serving the same function; the documentation of a transaction, as in a contract. See also, **Schedules** and exhibits which often accompany a PSA or a merger agreement.

Purchase Price Adjustment [Post-Closing] - A provision in many definitive agreements involving a non-public target or seller which adjusts the purchase price for changes in the target or seller's financial condition between the date of its latest financial statements given to the buyer during due diligence and the closing. The purchase price adjustment usually takes place after closing based on a post closing balance sheet prepared by one party to which the other party can object. Needless to say, this is fertile ground for disagreements, which the parties often anticipate by inserting an ADR provision in the agreement generally taking the dispute to an independent major accounting firm for resolution, similar to arbitration but usually based on written submissions as opposed to testimony, witnesses, etc. Earn-outs and escrow agreements are additional forms of purchase price adjustments.

Raider - A person seeking to acquire a target or put a target in play contrary to the wishes of the target. See, e.g., T. Boone Pickens in a prior life and Carl Icahn perhaps, today, although I suspect the latter would not agree with this characterization, preferring to call himself an activist investor. The fact is that true raiders are a dying breed today.

Recapitalization or Recap - A change in the capital structure of a company and another way to raise capital, albeit often risky. Recapitalization entails substituting debt for equity on the company's balance sheet. In other words, increasing debt [and thus cash] and reducing equity. Cash generated through financing [debt] can be used to fund a special dividend for shareholders or re-purchasing shares [Self-Tender] on the open market. The most important distinction between a recapitalization and an LBO is that public shareholders retain ownership [equity] in the recapitalized company, albeit their stock may be worth considerably less than pre-recapitalization; this is one reason why a stock buy-back often will accompany recapitalization. Also, this puts cash in the shareholders' pockets and still allows them to retain a level of ownership. Recapitalization is heavily dependent on the availability of financing and most important, payment terms [interest] which can fluctuate from day to day. Recapitalization, like business combinations, can trigger certain requirements under the federal securities laws.

Reporting Company - Here is the simple definition: a company whose shares trade on one of several public exchanges [a public company], or a private company which has assets in excess of $10M and more than 2,000 shareholders or 500 non accredited shareholders. Section 12 of the '34 Act lays this all out, but in either circumstance, the company is required to comply with the statute's disclosure requirements. See also section 15(d) for a third category. Section 12 reporting companies are subject to section 13 continuous disclosure requirements [e.g., 10Ks] and accounting and internal control dictates under 13(b). Section 15(d) reporting companies appear to only be subject to continuous disclosure requirements.

Representations and Warranties - Essentially promises or affirmation of certain facts or conditions by one or both parties set forth in the definitive agreement. A simple example: the seller represents and warrants that it is in compliance with all material environmental laws, regulations, etc. The bidder warrants that it has the authority to enter into the transaction. As Professor Maynard points out, reps and warranties serve a variety of important purposes. First, they are disclosure tools which can confirm the results of due diligence. For example, the seller reps and warrants that their financial statements are in compliance with GAAP, further confirming the bidder's financial due diligence. Second, they can serve as risk allocation tools when tied to indemnification provisions provided they **Survive** the closing, meaning the definitive agreement must be clear on this point. Finally, if there is a gap between the execution of the definitive agreement and the closing, a breach may provide either party, generally the bidder, with a basis for walking away from the transaction. Hence the term "bring-down," that is, makes clear in the definitive agreement that the representations and warranties are in effect at the closing. Buyers prefer to get unqualified representations, for example, whereas sellers are reluctant to give representations because they create contingent risk post-transaction and if they have to provide reps and warranties, they will try to add "qualifiers" such as reasonableness, knowledge and materiality. Not surprisingly, these provisions are often heavily negotiated. You absolutely need to understand this aspect of M&A transactions. Covenants are somewhat different. Here, the parties promise to do something, either before the deal closes or after. In a sense, they are similar to closing conditions. The important difference is that breach of a covenant can result in walk away rights or indemnification rights post closing, assuming they survive the closing.

Reputation - While dollars and cents are important, companies which seek to engage in frequent M&A transactions need to be conscious of their reputation. Companies with bad reputations, for example, scorched earth tactics, underhanded negotiations, being uncooperative, lack of confidence or frequent dithering during transactions, may get shut out of deals that they otherwise would be invited to, although often "greed" will win out. Thus, good M&A practitioners approach every transaction on its own terms but recognize that the "industry" is constantly assessing whether they are suitable partners for future deals. Beating the hell out of a seller to achieve maximum pricing may work in one deal, but it could backfire down the road for other transactions.

Revenue - Gross income, before taxes and other deductions, generated by a business from its operations.

Reverse Triangular Merger - A **Triangular Merger** in which a subsidiary of the acquiror (generally a special purpose shell corporation) is merged into the target corporation. While the target corporation is the surviving corporation of such a Merger (and the subsidiary disappears), the shares of the target corporation are converted into the right to receive cash or securities (usually of the acquiror), and the shares of the acquisition vehicle or subsidiary are converted into shares of the surviving corporation which thus becomes a subsidiary of the acquiror. This **structure** is frequently used to avoid Shareholder votes or supermajority voting requirements, or consent rights of the target corporation's bondholders.

Revlon Duty - Based on the Delaware Supreme Court decision in Revlon, Inc. v MacAndrews and Forbes Holding, Inc. (1986); this heightened duty obligates the board to achieve the highest reasonably attainable value for shareholders when the corporation is for sale, change of control or a break up is inevitable. Value can be in the form of the purchase price for the shares, recapitalization, a business combination or even no sale. The classic case is when the board actively shops the company to bidders through an auction. It is not always easy to determine when a corporation is for sale or a change of control. Generally, the board must take some affirmative step towards a change of control or sale. A hostile takeover in of itself does not constitute a change of control for Revlon purposes unless the target's board decides to turn it into a friendly takeover or negotiated merger. Moreover, the highest reasonably attainable value [e.g., price] dies not necessarily mean the highest price a bidder is prepared to pay, especially if the bid comes with conditions that are unreasonable; nor is the board required to obtain the highest price *per se*. As long as the board has gone through a reasonable, independent, deliberative and informed decision making process their determination as to the purchase price, for example, generally will be given great deference under Revlon. Yet another example of the importance of process post Van Gorkam.

Many other states adopt the Revlon duty, but not all of them and some confuse the situation by adopting constituency statutes that either permit or make mandatory board consideration of other factors such as employees, the community and customers in addition to shareholder value. When a change of control is in the works, the board is commonly referred to as being in Revlon mode. Keep this in mind: an auction is not the only device which the board, in Revlon mode, may use to meet the heightened state of judicial review. The central question is whether the board's efforts were reasonably aimed at maximizing shareholder value.

Risk - Takes all shapes and forms depending on the nature of the companies involved. For this course, we are talking about risks that can imperil the transaction or its outcome for either party. For the anxious buyer, slowing down the due diligence and negotiation process may lead to the risk of another bidder emerging. On the liability side, if the buyer assumes tort liability in exchange for a reduced purchase price on the assumption that there is little risk of losses occurring, unanticipated losses can adversely affect the economic value proposition. And perhaps the greatest risk of all is that the buyer has over-valued the target or asset, over-pays and the acquisition does not contribute to its growth, or even worse, reduces growth. For the seller, generally the longer the transaction goes on, the greater the chances [risk] the purchase price will drop. If a seller retains liability for torts on the assumption that there is little risk of losses occurring in exchange for a greater purchase price, unanticipated losses can be a problem. And this is why buyers perform extensive due diligence, and then, based on the information, they structure the transaction in a way to eliminate or at least materially reduce identified risk. Stated another way, risk management is an important factor in M&A transactions, and lawyers need to appreciate this, be able to assist their clients in indentifying risks and quantifying them [e.g., potential for occurring and costs or losses if they do occur] and devising strategies to manage them within the context of the transaction. See also **Structure,** due diligence, representations, warranties and covenants and insurance.

Rule 145 - Rule promulgated by the SEC pursuant to the federal securities laws which sets forth certain requirements for business combinations mostly relevant to public companies. For example, Rule 145 (a) (2) makes clear that if a security is exchanged as part of a merger, the offer or sale of the security is subject to certain '33 Act conditions [e.g., registration under section 5]. Remember, when a security is involved in an M&A transaction, the federal securities laws are triggered in some form or fashion and possibly state securities laws ("Blue Sky Laws"). There also are a series of SEC rules which provide safe harbors for communications which arise out of M&A transactions. See, e.g., Rules 168 and 169. These rules are designed to ameliorate certain communications restrictions imposed by section 5 of the '33 Act. The point here is that depending on the companies involved in a business combination, certain aspects of the federal securities laws may be triggered which only add to the complexity of the transaction.

Sarbanes-Oxley Act of 2002 - Very important amendment to the '34 Act which addresses a number of actions reporting companies must take to ensure the integrity of their financial statements, including books and records and accounting and auditing practices. The Act also contains nettlesome "reporting up" requirements for attorneys. In an interesting twist, SOX added to the requirement that audited financial statements conform to GAAP the requirement that they "fairly represent" the company's financial performance and position. Stated another way, compliance with GAAP or even generally accepted practices may not be sufficient to meet the "fairly represent" requirement. This is the lesson of U.S. v. Simon, although it pre-dated SOX by more than thirty years. Not surprisingly, the cost and time associated with complying with SOX can be significant, which is one reason some companies decide to go private.

Schedules - For complex transactions the definitive agreement often will be accompanied by schedules that are considered part of the agreement and list everything from pending litigation, property locations, patents that are being transferred, etc. These are important documents for several reasons, not the least of which is that a party's indemnification obligations may be tied to what is listed on the schedule. For example, the seller may be responsible for all "retained litigation," that is, litigation pending before the transaction closes. The PSA will contain a provision which obligates the seller to indemnify the buyer for this litigation. The source document for what is pending is the schedule of retained litigation. Putting schedules together can be pure drudgery, but they have to be done right and started early to avoid last minute scramblers which can lead to mistakes. The information for the schedule is developed during the due diligence. Think of schedules as data and other information that support defined terms in the definitive agreement and representations and warranties. Schedules are different from **Exhibits,** but they are both critical to documenting the transaction.

SEC - United States Securities and Exchange Commission. SEC is the principle federal agency that oversees the implementation and enforcement of the federal securities laws and related laws [e.g., Sarbanes-Oxley]. The Commissioners have broad power to promulgate rules and regulations under the federal securities laws and act as an administrative tribunal. The SEC can also bring civil enforcement actions and recommend criminal actions to the DOJ. A very powerful agency which is not above political influence, but their lawyers and other personnel are generally competent. This is more a rule for the securities course I teach: do not mess with the SEC. They can be dealt with, but if they get the sense that you are trying to jerk them around [see, e.g., Martha Stewart], that can make life for your client, and potentially you, extremely miserable. Frankly, this goes for almost every regulatory agency that may be a stakeholder in an M&A transaction. SEC Regulation M-A & Rule 145 and related rules and regulations, as well as others, may apply when public/reporting companies engage in business combinations.

Second Request - Very broad and onerous request for additional information and other documentary material made by the FTC or the Antitrust Division of the DOJ following a HSR first filing that does at least three things that make parties to a transaction nervous: 1) depending upon the transaction, there is an additional waiting period until there has been "substantial compliance" with the second request which among other things, gives potential bidders who may not have antitrust problems time to enter; 2) the additional waiting period gives the FTC or DOJ staff additional time to pursue their own investigation of the proposed transaction which raises the potential for an adverse determination; and 3) further drives up the cost of the transaction, given the reams of information that needs to be compiled and transmitted to the government. It is every buyer's nightmare when it receives a second request. It has spent countless hours on due diligence, spent mounds of money in the process, etc., and now it has to sweat over whether the transaction will be approved from an antitrust perspective. This is why many potential buyers will hire an antitrust expert to help them assess early whether there are going to be antitrust issues as well as guide the company through the antitrust review process, including putting together the HSR submissions.

Security - Three classes are devoted to what is a security in the securities regulation course. Deceptively complex subject. For purposes of this course, we are talking primarily about stock [i. e., common stock]] and occasionally corporate bonds or notes. The importance of all this is that if a security is involved in a transaction, <u>at least</u> the federal securities laws and regulations come into play in some fashion. This can drive up the cost and time for the parties, generally the bidder. For example, if the bidder plans to issue stock for all or part of the consideration for the transaction, unless it can find an exemption to the 1933 Act registration requirements [e.g., private placement or Regulation D offering], it may have to comply with the onerous section 5 [33 Act] registration requirements including SEC review of the offering. And of course, once a security is involved for section 12 ['34 Act] reporting companies [e.g., Textron] will need to follow the disclosure and federal proxy rules. Also, don't forget about Rule 10b-5 antifraud issues.

Self-Dealing - Having an interest in both sides of a transaction. A director of a corporation may be involved in a transaction with a company he owns or manages; managers may try to sell a public company to themselves in an MBO; or a controlling shareholder may want to merge it with another corporation it owns. All of these transactions raise conflict of interest concerns and may subject a transaction to the Entire Fairness Test enunciated in <u>Weinberger</u>. This does not mean that all self-dealing is necessarily problematic. For example, the by-laws or state statutes may allow certain self-dealing where there has been full disclosure and the transaction is in the best interest of the corporation.

Shareholder - For purposes of this course, someone who has an ownership interest in a corporation and the right to vote. In public companies, common shares. Very critical stakeholders in transactions involving public companies because they have certain rights, such as voting on certain matters [e.g., material transactions, election of Board members] and various remedies if they believe they are being treated unfairly [e.g., appraisal rights, injunctive relief, class action lawsuits]. Also, as we have seen, depending on the nature of the transaction, the board's ultimate obligation may extend to protecting the best interests of the shareholders or it may not, as in the case of hostile takeovers. As a practical matter, in today's corporate world, shareholders have relatively little influence over the day to day running of the companies they ostensibly own, which is one reason why the shareholder rights movement has become an increasingly important issue for Boards and CEOs. They can, however, be an important force to be reckoned with in an M&A transaction, and you need to clearly understand their rights and legal options in this regard. Indeed, when structuring a transaction that involves shareholder approvals, the client and the deal lawyer are going to pay close attention to this subject. It's one thing for the parties to reach a definitive agreement; it can be an entirely different story if shareholder approval is required or the shareholders aren't happy with the transaction. At common law, unanimous shareholders approval was required to consummate a deal. The general statutory rule today, for mergers, is a majority approval of voting shares is required. See, e.g., DGCL §251(c). Can you guess why the common law rule was changed? Additionally, you will always want to review a company's Articles of Incorporation [Certificate of Incorporation for DE companies] as here you may find additional rights provided to the shareholders, e.g. more cumbersome voting requirements etc.

Shareholder Litigation - Generally takes the form of shareholder class actions, which include injunctions, appraisal rights actions and 10b-5 actions for material misstatement or omissions by senior management and the board. The specter of 10B-5 based litigation can be a powerful deterrent factor for public companies as well as an enforcement tool for the federal securities laws. While the individual shareholders may have little at stake, aggregation of their claims in a class action can present a huge exposure. Derivative actions are another less common form of shareholder litigation. Most shareholder litigation arising from M&A transaction involves allegations of conflict of interest.

Shareholder Value Maximization Model - The widely accepted principle that the primary objective of boards and senior management is to maximize shareholder value which can take a variety of forms, ranging from improving performance and hence stock price, to getting the highest reasonably available price for the company when it is up for sale or a change of control. The latter is the so-called Revlon Duty. Interestingly, in the context of hostile takeover attempts, the board has leeway to resist the attempt if it has a reasonable basis for showing that the bid is not in the long term best interests of the corporation or shareholders. In other words, despite the day to day drum beat for quarterly growth, the board is not obligated to accept a hostile bid, even if it represents a premium. The shareholder maximization principle is not without qualification, depending on the law of the state in which the corporation is incorporated [Internal Affairs Doctrine].

Short-Form Merger - Generally, mergers require shareholder approval, but in most states, if one company is the parent of the other and owns a large percentage of its shares (e.g., 90% under DGCL §253 and see DGCL §251(h) which streamlines back end mergers when the controlling shareholders holds a majority of the voting shares but less than 90%) the parent may merge with the subsidiary [short-form merger] with only the approval of the parent's board, meaning they can "squeeze out" or "freeze out" the minority shareholders without the need for their vote. However, unhappy shareholders may still be entitled to appraisal rights and theoretically, the directors owe the same fiduciary duty to the minority shareholders with respect to price and procedure; however, as we shall see in class 26, absent fraud or some other egregious wrongdoing, as a practical matter minority shareholders don't have much power to challenge short-form mergers themselves. Their remedy is generally appraisal rights, if the transaction qualifies.

Special Committee - A committee of a board made up only of disinterested independent directors, to which an important board responsibility is referred when some members of the full board have a conflict of interest. For example, as discussed previously, if the CEO is the Chairman of the Board and is leading an MBO group which desires to buy the company, a special committee, minus the CEO [and any other interested directors], will be appointed to assess the transaction and take any additional steps necessary to ensure the shareholders are protected, often leading to an auction. The lack of a special committee was one of the reasons the Delaware Supreme Court resorted to the Entire Fairness Test in Van Gorkam against Signal's board. The presence of a Special Committee and a non-controlling, majority of the minority voting requirement led the same court in Kahn v. W&F Worldwide Corp. to invoke the business judgment rule to evaluate the board's activities.

Squeeze-out or Freeze Out Merger - A merger designed to eliminate minority interests in a company or subsidiary. The common stock owned by the minority shareholders is converted into cash or occasionally stock or debt securities of the parent company. Squeeze-outs can be accomplished in Delaware for the sole purpose of eliminating the minority. In other words, there does not have to be a business reason. See DGCL sections 203 and 251(h). State law generally requires fair treatment of the minority and, in many circumstances, grants them appraisal rights. Shareholders also have the right to sue for breach of fiduciary duty when they are complaining about something more than just the price, for example, unfairness in the procedures used to determine the price or inadequacy of the disclosures. Weinberger is the classic Delaware case when it comes to the perils of a squeeze-out merger from the board's perspective, but as discussed previously, Kahn v. W&F Worldwide Corp. provided controlling shareholders with an important "out."

Stakeholders - The internal and external persons or entities that can influence the outcome of an M&A transaction. For example, the board of directors and senior management, the V.P. of Mergers & Acquisitions and general counsel's office are generally the key internal decision makers for large companies supplemented by a host of other in-house operational and functional personnel. Of course, the shareholders are important stakeholders, especially if they have to approve the transaction on either side or have the right to block it. Employees also can be a factor, especially if they become distracted or fearful of a pending transaction and productivity drops. Outside counsel, Investment Bankers, and auditors are three key external stakeholders who play an important role in a transaction. And don't forget about third parties such as vendors, lessors, creditors and the all-important customers. Governmental entities which may be brought to bear include the SEC for public companies, FTC or DOJ for antitrust issues or even the courts, if disputes arise. The point of all this is that when sizing up a transaction, each side needs to identify who the key stakeholders are and determine how they need to be managed or otherwise satisfied to facilitate the transaction.

Stalking Horse - Colloquial term for a prospective buyer in friendly or negotiated transaction who is being used by the target company to attempt to attract higher offers. As should be apparent by now, all kinds of schemes and machinations can be at work in a M&A transaction, either to drive the price up or down, depending what side of the equation your clients is on, or even frustrate the transaction in the case of a hostile takeover. Yet another reason why, as the deal lawyer, you need to know what your client's objectives are before you launch into the transaction.

Standstill Agreement - An agreement not to buy additional shares, solicit proxies or take other specified actions for a period of time. In other words, stop the train for a limited period of time. Such agreements can be between the bidder and target or even third parties [e.g., potential third party bidder]. These agreements are used frequently when the parties are negotiating turning a hostile takeover into a friendly takeover, when the issuer sells a large block of shares privately, and when the issuer purchases a block of shares privately.

Stock-for-stock transaction or **stock-for-stock merger** – A transaction where the stock of the target corporation is acquired, and shareholders of the target corporation receive the acquiror's stock as consideration. Another term for this is a stock swap. Here is a case where the target company is going to do some due diligence on the bidder to ensure the sustainability of its stock price. Stock-for-stock transactions entail a conversion or exchange ratio to value the bidder's shares compared with the target's. For example, the exchange ratio is 2 of the bidder's shares for one of the target's. And yes, stock-for-stock transactions can lead to dilution of the bidder's share price, which is another factor to consider. Finally, such transactions do not involve a change of control if the target's shares are widely disseminated. This can have important implications for whether the board is in **Revlon** mode.

Structure - The legal form the deal takes in order to achieve certain of your client's objectives. There are three basic structures: asset, stock purchase, and merger, although the latter two have several variations and can even overlap. The structure of a transaction will play a critical role in achieving your client's objectives as well as trigger the relevant corporate formalities which need to be satisfied. In short, every transaction has advantages and disadvantages, which the deal lawyer needs to master and the client needs to balance in its decision making. As previously discussed, there rarely is a perfect deal in terms of attaining the client's objectives; but, there can be a best deal under the circumstances. Interesting fact: for many public or large company bidders the tax department or lawyer will determine the structure very early in the process. Bet you thought it was the lawyers. See Taxes.

Successor Liability - Simply put, in any M&A transaction, who ends up with the liabilities (and rights) of the target or seller? The general rule is that in an asset transaction the buyer is liable only for the liabilities it expressly assumes, but as we'll see, there are some notable exceptions. In a merger, however, the surviving company assumes the liabilities and rights of the target by operation of law, with some minor exceptions. Avoiding successor liability is a good example of a buyer's objective. As the deal lawyer, once you know this, you can attempt to structure the transaction to achieve this objective. All things being equal, you will recommend an asset transaction. Unfortunately, life is rarely this simple, but you get the point.

Superfund - A commonly used name for a series of federal environmental cleanup statutes enacted in the 1980s under the title, "Comprehensive Environmental Response, Compensation and Liability Act," often called CERCLA. The name Superfund comes from a federal fund used for environmental clean-up that is derived from taxing the chemical, petroleum and other industries that generate hazardous substances. Theoretically, the persons who created the problem must pay for clean-ups under Superfund. However, what happens when that party is defunct or judgment proof? Well, the EPA [or state equivalent] can go directly against the person who owns or operates the property for clean up, irrespective of whether they caused the problem. Also, make no mistake about it, the investigation and remediation of Superfund sites can be extremely costly. Not surprisingly, this may be another objective for you client in an asset transaction: avoiding Superfund liability arising from the operations of the seller or the assets acquired. But remember this, under Superfund, if you own or operate contaminated property, whether you put it there or not, as far as the EPS is concerned, you have the primary obligation for any clean up. If a seller has provided you with indemnification, that's between you and them, although the EPA will generally go after all principally responsible persons [PRP]. So, the deal lawyer may recommend, as part of the deal structure, that the client do an asset transaction and not buy a plant which is contaminated. He or she might also attempt to get the seller to indemnify the client for any Superfund liability to avoid, or at least greatly minimize the risk that the buyer gets stuck with Superfund liability. The EPA doesn't think much concerning the bar to successor liability associated with asset transactions and continually looks for ways around it to get the party who has the money. Keep this tidbit in mind: it is not uncommon for Superfund sites or any contamination, to be accompanied by multi-party third party tort litigation either for personal injury or property damage or both, which can be costly. Moreover, both Superfund proceedings and third party litigation often are long tail exposures, which are not easily identified or assessed in due diligence. Finally, the specter of potential Superfund and related liability, federal, state, third party or all three, is why due diligence generally includes an environmental audit of the Target if its operations own facilities or otherwise generate hazardous materials and wastes. Indeed, such audits are almost automatic when land or buildings are purchased, regardless of how the target used them.

Survives - As previously discussed, if a representation/warranty, for example, survives the closing (for a specified period of time), it can form the basis for an indemnification claim. Not to be confused with "bring down" which is a provision in the definitive agreement that brings reps/warranties from the definitive agreement to the date of closing. Here, if there is a breach, often a "material" breach is required in the agreement; the aggrieved party may have termination rights or at least the basis for renegotiating some aspect of the deal, often the price. "Bring down" clauses serve a similar purpose. For example, they "bring down" the representations and warranties to the closing which may provide one of the parties with the opportunity to terminate the transaction if breached prior to closing

Synergy or **Synergies** - The overriding justification for many acquisitions for strategic buyers. Simply put, the cost savings and efficiencies which result from the transaction which lead to growth. The idea is that the combined companies will exceed the performance of the individual companies. In other words, the value of the combined companies will exceed the value of the sum of the two parts operating independently. Synergies can either increase revenues or reduce costs or both. For example, there may be redundant employees, headquarters, plants, sales force and distributors that can be eliminated by the NEWCO thus reducing costs and in turn increases profits. There also may be other savings, such as increased buying power, which can result in lower materials costs. Acquiring new technologies through an acquisition can lead to increased revenues and profits. Here is a simplified example to further illustrate the point. Company A has 1,000 employees with revenues of $1B; Company B has 500 employees with revenues of $500M. The companies are in the same business. Company B has some new technology which could be adapted to one of Company A's major product lines. In **Valuing** Company B for purposes of determining how much to pay for it, Company A determines that it can eliminate 250 employees from the combined companies and still achieve the same revenues. The savings from the staff reductions are estimated to be $25M in the first year alone. Company A also determines that the new technology will increase its sales in the aforementioned product line by 50%, taking those revenues from the current $100M to $150M in the first year alone. Thus, Company A has identified $75M in synergies for the first year alone and all things being equal [e.g., discounted cash flow analysis; due diligence] it can justify paying more for Company B than it otherwise would have without the synergies. In other words, the higher the synergies arising from the combination, the greater the value of the target or seller. Keep in mind, however, that like the **Valuation** methodologies buyers use, arriving at the synergies number often requires many assumptions, which if proved wrong can turn the deal into a loser. Occasionally, deal people will inflate the synergies numbers to justify the acquisition or merger, which is generally a mistake. Also, it should be obvious that synergies are generally only relevant to a strategic buyer. A financial buyer generally deals in one-off transactions where they are buying the company as a standalone operation. Thus, there is generally nothing to combine it with and therefore no synergies. Does this mean that financial buyers are at a disadvantage when strategic buyers are looking at the same deal? Depends. Law students seem to have trouble understanding synergies, or at least why they should pay attention to the subject. The reason the deal lawyer needs to pay attention is because the basis for many of the synergies needs to be validated during the due diligence process as well as protected in the definitive agreement.

For some reason, students have a difficult time grasping this important aspect of M&A transactions. It really is not that complex conceptually, and although identifying synergies is generally the province of the business people; the deal lawyer has a role to play in due diligence and drafting of the definitive agreement in this regard which we will discuss in the course.

Takeover Defenses - Delaware case law allows target boards considerable, but not unlimited leeway to adopt defenses which have the potential to preclude takeovers, provided that they do not completely foreclose proxy contests. See the Unocal decision as modified by Unitrin, discussed in the text. Basically, assuming the board has the statutory power to adopt one or more defensive measures, there must be a reasonable threat of a takeover that is not in the best interest of the corporation and shareholders, and the measures adopted must be proportionate to the threat. Because the board has an obligation to maximize shareholder value, it cannot entirely preclude a hostile bidder's efforts to acquire the company. Such defenses include the poison pill, leveraged recapitalization, acquisition of another company to make the takeover more expensive and even Greenmail, but this is becoming less common in recent years. State antitakeover statutes, such as DGCL 203, offer another potent "defense" as well as perhaps the strongest of the entire lot, staggered boards. Interestingly, the heightened scrutiny test of Unocal is not shared by other states, such as New York, which apply the lesser business judgment rule to defensive measures.

Taxes - We all know what taxes are, and for businesses, they are a big expense that can reduce profits. Taxes can be a very important factor when considering an acquisition. Many commentators argue that it the single biggest consideration, especially for large companies; others think it's a bad reason for doing a deal. Indeed, in many companies the tax department will recommend the structure that best achieves tax benefits for the company. And you thought the lawyers did this. Here is an example which doesn't get into the arcane and complex application of tax law to M&A transactions. Company A has millions of losses that it can carry forward to reduce its federal taxes. Unfortunately, it has no profits to be taxed, and thus, the Net Operating Losses ("NOLs") are useless, at least for now. Company B has millions of dollars in profits and minimum NOLs and other reductions to its federal tax liability, so it's paying an effective federal tax rate of 33%. Company B's tax lawyers advise the CEO that if the two companies merge, the tax rate for the new NEWCO will be considerably less than 33%; thus, all things being equal, greater profits. Also, selling the assets of a company is a taxable event to the company itself. If the Seller has a little tax basis in the assets, all things being equal, it will have substantial taxable gain and could be a factor in the decision to sell. Also, if followed by a liquidation of the remaining entity and distribution of the proceeds to the shareholders, there is a second tax event. Another, often cited, major factor in an international merger is the "inversion" doctrine which allows the bidder [a U.S. company] to take on the legal home of the target [a non-U.S. company with a materially lower corporate income tax rate]. See, e.g., Pfizer's unsuccessful 2014 bid for AstraZeneca, a U.K. company as a clear example of the potential benefits of inversion to a U.S. company-billions.

There is an interesting tax device worth discussing, which can affect the structure of a transaction. Section 338(h)(10) of the Internal Revenue Code permits a target or seller to sell stock but the purchaser can treat the sale as an asset purchase, which provides certain tax advantages. This device appears to be what the parties in the TFS Acquisition selected in the transaction we will be discussing in some detail in the course.

Tender Offer - For purposes of this course, a bid for a company's shares made directly to the shareholders at a premium price [and other factors see "Wellman factors"], thus hoping to avoid an uncooperative target board. Tender offers must comply with the reporting, disclosure and other requirements of the **Williams Act**, embodied in Section 13 of the '34 Act and SEC rules and regulations thereunder. A self-tender is when a company offers its shares for sale, generally to its shareholders first. Keep in mind that boards have several options available to them, subject to the enhanced scrutiny standard of review set forth in the Unocal case and reaffirmed in the Airgas litigation, to ward off hostile takeovers which often lead to a tender offer. Tender offers are a form of stock purchase, one of the three basic structures. While mergers entail the purchase of the target's shares, they are not stock transactions for structural purposes.

Two Step Merger – Just what it says: The bidder acquires a majority of the target's shares; then the remainder at a later date through various mechanisms such as a "short form" DGCL 253 merger or a "backend merger" DGCL 251(h). The acquiror also can engage in a traditional or statutory merger to accomplish the same objective, but unlike the former two devices, the minority shareholders have a right to vote on the transaction, even though it may be academic. In any event, appraisal rights are available to dissenting shareholders under all three options depending on the circumstances. Tender offers also can result in a two step process, but appraisal rights are not available, for reasons we will discuss.

Transition Agreement - By now it should be clear that just because the closing has occurred, work may still need to be done by the buyer and seller. For example, integration. Another example is that for certain services and functions the seller may need to continue to perform for the buyer's benefit in a transition period. IT support, workers compensation and certain human resources functions are a few examples. As part of the transaction, the parties will enter into agreements to cover the scope, cost, reimbursement, etc. for such services or functions, hence the term transition agreement. Generally, the transition agreement will be included in the exhibits. Yet another post-closing activity that the parties need to keep track of.

Triangular Merger - Acquisition structure in which the target corporation is merged with a subsidiary of the bidder-acquisition vehicle, thus becoming a subsidiary of the bidder. Tax implications and liability issues often have a lot to do with the type of structure.

Unocal rule - A modification of the business judgment rule, used by courts in Delaware for evaluating takeover defenses. It requires that a response by the target's board be reasonable in relation to a "reasonable threat" to corporate policies posed by the bidder. This enhanced judicial scrutiny standard was announced by the Delaware Supreme Court in the case of <u>Unocal Corp. v. Mesa Petroleum Co</u>., 493 A.2d 946 (Delaware Supreme Court 1985), in which the court approved a discriminatory, defensive self-tender by Unocal to all its Shareholders except Mesa, the discrimination aspect of which has since been prohibited by the SEC. In any event, the rule makes it easier for courts to explain their decisions but is so general that it is of somewhat limited value in making predictions of what courts will do. Nevertheless, <u>Unocal</u> is an important case along with <u>Unitrin</u> and <u>Paramount v Time</u> for assessing the fiduciary duties of boards in hostile takeover situations, as well as crystallizing the division of authority between the board and the shareholders when faced with premium offers.

Unsolicited Bid - A hostile bid is generally unsolicited, that is, the bidder is not invited by the target to make an offer for the company.

Valuation - Basically, the process by which the parties to an M&A transaction determine the value of the company, division or asset to be acquired for purposes of establishing a purchase price. In other words, what is the target or seller worth which ultimately translates into a negotiated purchase price, often only after intense negotiations between the parties. Obviously, the buyer and seller will have different ideas as to value; the buyer is genetically disposed to value the company or asset at the lowest price possible; the seller wants the highest possible price, although truth be known, most unsophisticated sellers have no idea what their company is worth. However, it is more complex than this, especially from the buyer's perspective, because the most important question should be how the target or asset will increase growth. For example, a target which is performing poorly may have little intrinsic value, but it possess something that will have great value to the bidder, such as new product distribution channels or even key executives. Having said this, the parties use a variety of methods to arrive at value, including, as discussed previously, the discounted future cash flow analysis. Interestingly, whatever methodology is used, they are generally based on assumptions and can be remarkably subjective. The amount of anticipated synergies also can be part of the valuation process. If the bidder over-values the target, this means they will pay too much and the deal likely will turn out to be bad. At the other end of the spectrum, if the target undervalues its own business, it will leave money on the table but this result is often less apparent than the former. Valuation also applies to the court's attempt to figure out whether shareholders exercising their appraisal rights got the short end of the deal of the price offered for their shares. See the Weinberger case.

There are various methods used to arrive at valuation. The Discounted Cash Flow ["DCF], which is discussed in the text attendant the Weinberger case, is often used. Other methods include comparable company analysis, comparable transaction analysis, and asset valuations. Again, whatever method is used, the business people, along with financial and accounting advisors, control this process. And, it is a fact intensive undertaking which for complex transactions entails algorithms and other computer generated modeling. In the final analysis, however, there is a fair amount of guess work, albeit educated, going on.

So, this is great for transactions involving sophisticated companies. What do smaller companies, especially those with no M&A experience do when faced with an M&A transaction? Good question which we won't get into here except to say, as discussed above, if the bidder improperly values the target or asset, the transaction can be a failure. Likewise, if the target or seller of the asset undervalues itself or the asset to be sold, money can be left on the table. Obviously, the party to a transaction who has the best handle on valuation has a significant leg up.

Vertical Merger - As discussed previously, a business combination of companies which operate at different levels or different stages of the same industry. For example, Company A in our scenario seeks to acquire the company which services its jets worldwide or the supplier of the materials for its airframes. Vertical mergers can present anti-trust issues, but generally less so than horizontal mergers. Remember, however, that if the transaction meets the persons or monetary thresholds of HSR, at least one filing will need to be made irrespective of whether there is an antitrust problem.

Wall Street Journal - Widely read and well-respected daily publication which contains a wealth of information and commentary concerning international business transactions, including those which entail securities [Section C, "Money and Investing"] and M&A transactions [Section B, "Marketplace"]. Generally considered to be pro-business, the Journal is an excellent source of information for students who want to enhance their knowledge of and facility with key terms and definitions and see theory put into practice. The New York Times has beefed up its Business section in recent years and provides an interesting counter-point to the Journal, although the scope and breath of the topics pale in comparison. Another source of very useful information for students and practitioners is the Corporate & Securities "blog" on Linked-in. Among other things, it contains current information concerning SEC rule making which can be very helpful.

Walkaway - While this term is also used in a general sense to mean any right entitling a party to terminate an executed transaction agreement, it is often used specifically in a stock-for-stock transaction to indicate the point at which the stock price of one of the companies involved has changed so dramatically that a party has a right to terminate the transaction. Akin to a MAC.

White Knight - A friendly [or at least more tolerable] bidder who volunteers or is solicited by a target as an alternative to a pending hostile takeover bid from a different company or person. The threat of turning to a White Knight can be used to get the bidder to raise its price for the company.

Williams Act - The federal law governing filings, disclosures and related requirements for tender offers and going private transactions. Under 13(d) when a person or entity acquires more than 5% of another company's equity securities it must disclose the ownership including its intentions [e.g., investment, tender offer]. Sec 14(d) addresses procedures for when a tender offer commences. One of the underlying tenets of the '34 Act, as well as the '33 Act, is that disclosure cures a lot of problems for investors. But, disclosure here also serves to protect target companies, because it gives warning that someone might be coming after them, which they may use to shore up anti-takeover measures or identify White Knights, if so inclined. Not surprisingly, the entity accumulating the shares often prefers keeping its intentions secret as long as possible, because as soon as word concerning a possible takeover gets out, the target's share price is likely to increase, and thus, the transaction becomes more expensive. One of the schemes it may turn to accomplish this is parking shares with another party, which is illegal.

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