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Business Planning for Mergers and Acquisitions

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Business Planning for Mergers and Acquisitions

SECOND EDITION

Samuel C. Thompson, Jr.

UNIVERSITY OF MIAMI
SCHOOL OF LAW

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This book is dedicated to the professors at the University of Pennsylvania
School of Law who introduced me to the topics covered here:

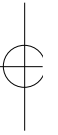
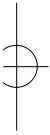
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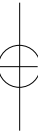
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Contents

Table of Cases	xxiii
Preface to the Second Edition	xxvii
Preface to the First Edition	xxviii
Acknowledgments	xxxii
Chapter 1 Introduction	3
SCOPE OF BOOK AND CHAPTER AND ETHICAL CONSIDERATIONS	3
1.1 INTRODUCTION TO CONSENSUAL TRANSACTIONS	11
1.2 INTRODUCTION TO TENDER OFFERS	15
1.3 A HISTORICAL AND ECONOMIC PERSPECTIVE ON MERGERS AND ACQUISITIONS	17
1.4 AN ASSESSMENT OF VARIOUS THEORIES OF MERGERS AND ACQUISITIONS	21
1.5 THE CURRENT M & A SCENE	22
1.6 INTRODUCTION TO THE ALI'S PRINCIPLES OF CORPORATE GOVERNANCE	26
1.7 REFERENCES	28
Chapter 2 Directors' Duties in Mergers and Acquisitions	31
SCOPE	31
2.1 INTRODUCTORY PROBLEMS ON DIRECTORS' DUTIES	32
2.2 INTRODUCTION TO DUTY OF LOYALTY AND DUTY OF CARE	33
2.3 INTRODUCTION TO DIRECT AND DERIVATIVE ACTIONS	33
2.4 ILLUSTRATIVE DUTY OF LOYALTY CASE IN DELAWARE	36
2.5 ILLUSTRATIVE DUTY OF CARE CASE IN DELAWARE	36
2.6 TO WHOM IS THE DUTY OF LOYALTY OWED: THE DELAWARE LAW	37
2.7 ILLUSTRATIVE BUSINESS JUDGMENT RULE CASE: REQUIREMENT OF DISINTERESTEDNESS	39
2.8 THE RELATIONSHIP BETWEEN DERIVATIVE ACTIONS AND THE BUSI- NESS JUDGMENT RULE IN DELAWARE	40
2.9 APPLICATION OF THE BUSINESS JUDGMENT RULE IN ARM'S-LENGTH NEGOTIATED MERGERS AND ACQUISITIONS: DELAWARE LAW	40
2.10 THE LEGISLATIVE REACTION TO VAN GORKOM	51

2.11	ILLUSTRATION OF THE INTERFACE BETWEEN THE DUTY OF LOYALTY, THE DUTY OF CARE, AND THE BUSINESS JUDGMENT RULE IN CONSENSUAL TRANSACTIONS IN DELAWARE	55
2.12	APPLICATION OF THE BUSINESS JUDGMENT RULE IN A MANAGEMENT BUYOUT: THE NEW YORK APPROACH	68
2.13	INTRODUCTION TO THE INTRINSIC FAIRNESS TEST IN PARENT SUBSIDIARY MERGERS: THE DELAWARE LAW	70
2.14	THE PRIMARY PURPOSE TEST AND THE DEVELOPMENT OF AN ENHANCED BUSINESS JUDGMENT RULE FOR DEFENSIVE TACTICS: AN INTRODUCTION	87
2.15	INTRODUCTION TO POISON PILLS	94
2.16	INTRODUCTION TO THE DUTY TO AUCTION	100
2.17	THE “JUST SAY NO” DEFENSE IN THE TIME-WARNER TRANSACTION	103
2.18	INTERFERENCE WITH SHAREHOLDERS’ VOTING RIGHTS: THE COMPELLING JUSTIFICATION TEST	111
2.19	ENHANCED JUDICIAL SCRUTINY IN SALE OF CONTROL TRANSACTION	114
2.20	DUTY OF CANDOR AND MATERIALITY STANDARD IN DELAWARE	123
2.21	RECENT APPLICATIONS OF THE UNOCAL AND REVLON STANDARDS	126
2.22	THE ALI’S PROPOSED RULES RELATING TO THE DUTY OF CARE AND THE BUSINESS JUDGEMENT RULE	137
	REFERENCES	142
	Chapter 3 Basic Rules Regarding the Right to Vote and Dissent in Mergers, Compulsory Share Exchanges, and Asset Acquisitions	143
	SCOPE	143
3.1	INTRODUCTORY PROBLEM ON SHAREHOLDERS’ RIGHT TO VOTE AND DISSENT	144
3.2	LEGAL EFFECT OF A MERGER AND SHARE EXCHANGE	144
3.3	ILLUSTRATION OF DOCUMENTS TO BE FILED WITH STATE TO EFFECTUATE MERGER OR SHARE EXCHANGE	145
3.4	STOCK EXCHANGE REQUIREMENT OF SHAREHOLDER APPROVAL	146
3.5	THE MBCA LONG FORM MERGER AND SHARE EXCHANGE PROVISIONS: ACQUISITION OF UNRELATED TARGET BY ACQUIROR	147
3.6	DELAWARE LONG FORM MERGER PROVISIONS: ACQUISITION OF UNRELATED TARGET BY ACQUIROR	165
3.7	THE MBCA SALE OF SUBSTANTIALLY ALL OF ASSETS PROVISION	175
3.8	THE DELAWARE SALE OF SUBSTANTIALLY ALL ASSETS PROVISION	180
3.9	THE DE FACTO MERGER DOCTRINE	184
3.10	TRIANGULAR (OR SUBSIDIARY) ACQUISITIONS	194
3.11	IS CLASS VOTING REQUIRED?	200
3.12	DEALING WITH PREFERRED SHARES	207
3.13	SHORT FORM MERGERS	210
3.14	THE CALIFORNIA APPROACH TO LONG FORM MERGERS, SALES OF ASSETS, SHORT FORM MERGERS AND DISSENTERS’ RIGHTS	211
3.15	THE ALI’S RULES RELATING TO DIRECTOR ACTION AND	

SHAREHOLDER VOTING AND DISSENTING IN ARM'S LENGTH MERGERS AND ACQUISITIONS	220
REFERENCES	229
Chapter 4 Introduction to Securities Regulation	231
SCOPE	231
4.1 INTRODUCTORY PROBLEMS	232
4.2 INTRODUCTION TO (1) THE REGISTRATION REQUIREMENTS UNDER §5 OF THE SECURITIES ACT OF 1933, (2) EXEMPTIONS FROM REGISTRATION, AND (3) THE PRINCIPAL LIABILITY PROVISIONS	232
4.3 INTRODUCTION TO GUN JUMPING UNDER §5(c) IN THE CONTEXT OF AN EXCHANGE OFFER. See Rule 135.	240
4.4 INTRODUCTION TO INTEGRATION OF DISCLOSURE UNDER THE SECURITIES ACT OF 1993 AND THE SECURITIES EXCHANGE ACT OF 1934	242
4.5 ILLUSTRATION OF IMPACT OF §11 OF THE 33 ACT	246
4.6 INTRODUCTORY PROBLEMS ON PUBLIC OFFERINGS	250
4.7 GUIDE FOR COMPLETING A STATUTORY SECTION 4(2) PRIVATE PLACEMENT	251
4.8 REGULATION D—EXEMPTIONS FOR TRANSACTIONS INVOLVING LIMITED OFFERS AND SALES	252
4.9 EXEMPTION UNDER STATE LAW. SEE NASAA UNIFORM LIMITED OFFERING EXEMPTION	266
4.10 SALE OF RESTRICTED SECURITIES UNDER RULE 144	266
4.11 SALE OF RESTRICTED SECURITIES UNDER SECTION 4(1-1/2)	272
4.12 THE APPLICABILITY OF RULE 10b-5 IN MERGERS	274
4.13 MATERIALITY	279
4.14 INTRODUCTION TO THE SEC'S M&A RELEASE AND AIRCRAFT CARRIER RELEASE	283
REFERENCES	284
Chapter 5 Introduction to the Tax Aspects of Mergers and Acquisitions	285
SCOPE	285
5.1 BASIC INTRODUCTORY PROBLEM	286
5.2 INTRODUCTION TO REALIZATION AND RECOGNITION CONCEPTS	286
5.3 OVERVIEW OF TAXATION OF MERGERS AND ACQUISITIONS	287
5.4 SUMMARY OF TAXABLE ACQUISITIONS AND LBOs	287
5.5 TREATMENT OF TARGET'S SHAREHOLDERS IN A TAXABLE ACQUISITION	288
5.6 TREATMENT OF A TARGET CORPORATION IN A TAXABLE ACQUISITION	288
5.7 TREATMENT OF ACQUIROR IN A TAXABLE ACQUISITION	294
5.8 TREATMENT OF LBOs	295
5.9 INFORMATION STATEMENT DISCUSSION OF THE TAXABLE REVERSE SUBSIDIARY MERGER AND RESULTING FEDERAL INCOME TAX ASPECTS IN TIME'S ACQUISITION OF WARNER	296
5.10 SUMMARY PROBLEMS ON TAXABLE ACQUISITIONS	297

5.11	SUMMARY OF ACQUISITIVE REORGANIZATIONS	297
5.12	ASSET REORGANIZATIONS	303
5.13	STOCK REORGANIZATIONS	304
5.14	OVER AND DOWN REORGANIZATIONS UNDER §368(a)(2)(C)	305
5.15	SUMMARY OF TREATMENT OF PARTIES TO A REORGANIZATION	305
5.16	PROXY STATEMENT DISCUSSION OF THE TAX-FREE REVERSE SUBSIDIARY MERGER AND RESULTING TAX CONSEQUENCE IN THE ORIGINALLY PROPOSED BUT ABORTED ACQUISITION OF WARNER BY TIME FOR TIME STOCK	306
5.17	COMBINATION STOCK ACQUISITIONS AND TAX-FREE SECTION 351 CONTRIBUTION	306
5.18	INTRODUCTION TO THE NONACQUISITIVE REORGANIZATIONS	307
5.19	INTRODUCTORY PROBLEMS ON REORGANIZATIONS	308
5.20	THE IMPACT OF §382 ON THE CARRYOVER OF TARGET'S NOL AFTER AN ACQUISITION	309
5.21	INTRODUCTION TO ESOPS	312
5.22	ACQUISITIONS OF S CORPORATIONS	312
5.23	TAX TREATMENT OF GOLDEN PARACHUTES AND GREENMAIL PAYMENTS	313
	REFERENCES	313
Chapter 6 Introduction to Accounting for Mergers and Acquisitions		315
	SCOPE	315
6.1	BASIC INTRODUCTORY PROBLEM ON PURCHASE AND POOLING ACCOUNTING	315
6.2	INTRODUCTION TO THE BALANCE SHEET AND INCOME STATEMENT	316
6.3	INTRODUCTION TO THE PURCHASE AND POOLING METHODS	319
6.4	RULES GOVERNING APPLICATION OF THE PURCHASE METHOD	320
6.5	ELABORATION ON THE PURCHASE METHOD	323
6.6	RULES GOVERNING APPLICATION OF THE POOLING METHOD	327
6.7	ELABORATION ON THE POOLING METHOD	331
6.8	SEC'S ACCOUNTING REQUIREMENTS	337
6.9	SUMMARY PROBLEMS ON ACCOUNTING ASPECTS OF ACQUISITIONS	340
	REFERENCES	343
Chapter 7 Modern Valuation Techniques in Mergers and Acquisitions		345
	SCOPE	345
7.1	INTRODUCTORY PROBLEM ON VALUATION OF TARGET CORPORATIONS	347
7.2	IMPORTANCE OF MODERN VALUATION CONCEPTS FOR NON-VALUATION EXPERTS	348
7.3	INTRODUCTION TO PRESENT VALUE, NET PRESENT VALUE, AND INTERNAL RATE OF RETURN	350
7.4	PRESENT VALUE OF MULTIYEAR INCOME FLOWS: THE DISCOUNTED CASH FLOW AND NET PRESENT VALUE FORMULAS	355

7.5	ESTIMATING FREE (OR NEGATIVE) CASH FLOWS AND TERMINAL VALUE	358
7.6	USE OF THE CAPITAL ASSET PRICING MODEL (CAPM) IN DETERMINING THE APPROPRIATE DISCOUNT RATE	371
7.7	USE OF ARBITRAGE PRICING THEORY (APT) IN DETERMINING THE APPROPRIATE DISCOUNT RATE	380
7.8	INTERACTION BETWEEN INVESTMENT AND FINANCING DECISIONS	381
7.9	USE OF THE WEIGHTED AVERAGE COST OF CAPITAL (WACC) IN DETERMINING THE APPROPRIATE DISCOUNT RATE	382
7.10	APPLICATION OF DCF IN ACQUISITIONS THAT PRODUCE SYNERGIES	384
7.11	ILLUSTRATION OF THE APPLICATION OF DCF, NPV AND CAPM IN AN ACQUISITION CONTEXT	385
7.12	NON-DCF VALUATION TECHNIQUES: COMPARABLE COMPANIES AND COMPARABLE TRANSACTIONS	387
7.13	THE ROLE OF THE INVESTMENT BANKER'S FAIRNESS OPINIONS IN MERGERS AND ACQUISITIONS	393
	REFERENCES	406
Chapter 8 Introduction to Antitrust Law Aspects of Mergers and Acquisitions		407
	SCOPE	407
	PART I INTRODUCTION	408
8.1	BASIC INTRODUCTORY PROBLEM ON ANTITRUST ASPECTS OF MERGERS AND ACQUISITIONS	408
8.2	INTRODUCTION TO THE SCOPE AND PURPOSE OF THE ANTITRUST LAWS	408
8.3	PRINCIPAL ANTITRUST LAWS GOVERNING MERGERS AND ACQUISITIONS AND INTRODUCTION TO ANALYSIS UNDER SECTIONS 1 AND 2 OF THE SHERMAN ACT: THE MICROSOFT CASE	410
8.4	THE SUPREME COURT'S REVIEW OF THE LEGISLATIVE HISTORY OF THE AMENDED SECTION 7	415
8.5	MARKET SHARES ARE THE PRIMARY INDEX: OTHER FACTORS SHOULD ALSO BE CONSIDERED	417
8.6	SUPREME COURT'S PRIMA FACIE RULE OF ILLEGALITY: IF MERGER RESULTS IN (1) "UNDUE SHARE OF MARKET"; AND (2) "SIGNIFICANT INCREASE IN CONCENTRATION"	420
8.7	THE GOVERNMENT'S MOST SIGNIFICANT VICTORY: EMPHASIS ON TREND TOWARD CONCENTRATION	423
8.8	REBUTTING THE SUPREME COURT'S PRIMA FACIE CASE: THE GENERAL DYNAMICS DEFENSE	425
	PART II INTRODUCTION TO MICROECONOMIC FOUNDATIONS OF ANTITRUST MERGER LAW	429
8.9	SCOPE OF PART II	429
8.10	GENERAL PRINCIPLES REGARDING COMPETITION, MONOPOLY AND OLIGOPOLY	429

8.11	BASIC ECONOMIC PRINCIPLES FOR CONSTRUCTING THE COMPETITIVE AND MONOPOLY MODELS	432
8.12	THE PURE COMPETITION MODEL	447
8.13	THE MONOPOLY MODEL	450
8.14	COMPARISON OF MONOPOLY MARKET WITH A COMPETITIVE MARKET: THE WELFARE TRIANGLE AND THE TOTAL REVENUE AND COST FUNCTIONS	456
8.15	COMPUTATION OF RESULTS OF PRODUCTIVE EFFICIENCY GAINS FROM A MERGER TO MONOPOLY	460
8.16	OLIGOPOLY	465
8.17	PROBLEMS ILLUSTRATING THE MICROECONOMIC PRINCIPLES OF MONOPOLY AND COMPETITION	466
8.18	ANALYSIS OF EMPIRICAL STUDIES OF CONCENTRATION-PRICE RELATIONSHIP	470
	PART III DEPARTMENT OF JUSTICE/FTC AND NAAG HORIZONTAL MERGER GUIDELINES	476
	SCOPE OF PART III	476
8.19	INTRODUCTION TO 1992 DOJ/FTC HORIZONTAL MERGER GUIDELINES	477
8.20	INTRODUCTION TO 1993 NAAG HORIZONTAL MERGER GUIDELINES	480
8.21	BASIC ENFORCEMENT STANDARD UNDER THE 1992 DOJ/FTC HORIZONTAL MERGER GUIDELINES	482
8.22	BASIC ENFORCEMENT STANDARD UNDER THE 1993 NAAG HORIZONTAL MERGER GUIDELINES	489
8.23	ILLUSTRATION OF PRINCIPLES OF MARKET DEFINITION: ELASTICITY OF DEMAND	489
8.24	MARKET DEFINITION, MEASUREMENT AND CONCENTRATION UNDER THE 1992 DOJ/FTC HORIZONTAL MERGER GUIDELINES	492
8.25	MARKET DEFINITION AND CALCULATING MARKET SHARES UNDER THE 1993 NAAG GUIDELINES	502
8.26	HHI ANALYSIS OF SOME LEADING PRE-1982 HORIZONTAL MERGER CASES	503
8.27	OVERVIEW OF SECTION 2 OF THE 1992 DOJ/FTC GUIDELINES; THE POTENTIAL ADVERSE COMPETITIVE EFFECTS OF MERGERS	504
8.28	LESSENING OF COMPETITION THROUGH COORDINATED INTERACTIONS UNDER THE 1992 DOJ/FTC GUIDELINES	505
8.29	LESSENING OF COMPETITION THROUGH UNILATERAL EFFECTS UNDER THE 1992 DOJ/FTC GUIDELINES	509
8.30	APPLICATION BY COURTS OF 1992 DOJ/FTC GUIDELINES	512
8.31	THE POWER BUYER DEFENSE UNDER THE CASE LAW AND THE 1992 DOJ/FTC GUIDELINES	518
8.32	CONSIDERATION OF OTHER FACTORS UNDER THE 1993 NAAG GUIDELINES	518
8.33	THE CASE LAW ON EASE OF ENTRY: REJECTION OF THE GOVERNMENT'S "QUICK AND EFFECTIVE ENTRY TEST"	520
8.34	ENTRY UNDER THE 1992 DOJ/FTC GUIDELINES	521
8.35	ENTRY UNDER THE 1993 NAAG GUIDELINES	524
8.36	THE ECONOMIC CASE FOR AN EFFICIENCIES DEFENSE	525

8.37	THE WARREN COURT'S VIEW OF EFFICIENCIES: POTENTIAL COMPETITION IN MARKET EXTENSION MERGER	526
8.38	THE ELEVENTH CIRCUIT'S VIEW OF EFFICIENCIES DEFENSE: MUST BE SUBSTANTIAL AND BE PASSED ON	527
8.39	EFFICIENCIES UNDER THE 1992 DOJ/FTC GUIDELINES	528
8.40	EFFICIENCIES UNDER THE 1993 NAAG GUIDELINES	532
8.41	FAILING FIRM DOCTRINE UNDER THE 1992 DOJ/FTC GUIDELINES	532
	PART IV DOJ GUIDELINES FOR CONGLOMERATE AND VERTICAL MERGERS	533
8.42	1984 JUSTICE DEPARTMENT GUIDELINES ON CONGLOMERATE MERGERS	533
8.43	1984 JUSTICE DEPARTMENT GUIDELINES ON VERTICAL MERGERS	534
	PART V COMPETITOR AND TARGET STANDING UNDER SECTION 7	535
8.44	COMPETITOR'S STANDING TO CHALLENGE ACQUISITION UNDER SECTION 7	535
8.45	TARGET'S STANDING TO CHALLENGE ACQUISITION UNDER SECTION 7	537
	PART VI MERGER POLICY	539
8.46	MERGER POLICY	539
	REFERENCES	547
	Chapter 9 Hart-Scott-Rodino Premerger Notification	549
	SCOPE	549
9.1	INTRODUCTORY PROBLEM ON HART-SCOTT-RODINO PREMERGER NOTIFICATION	549
9.2	STATEMENT OF BASIS AND PURPOSE OF RULES IMPLEMENTING THE ACT	550
9.3	THE ACT: SECTION 7A OF THE CLAYTON ACT	551
9.4	A GUIDE TO THE PREMERGER NOTIFICATION RULES UNDER HART-SCOTT-RODINO	553
9.5	PREMERGER NOTIFICATION RULES FEDERAL TRADE COMMISSION PREMERGER NOTIFICATION RULES	566
9.6	NOTIFICATION AND REPORT FORM	574
9.7	SUMMARY PROBLEMS ON HART-SCOTT-RODINO	576
9.8	NATIONAL ASSOCIATION OF ATTORNEYS GENERAL: PREMERGER DISCLOSURE COMPACT	578
9.9	PROTOCOL FOR COORDINATING FEDERAL-STATE MERGER PROBES	579
9.10	SUMMARY STATISTICS ON HSR FILINGS, SECOND REQUESTS AND DISPOSITION OF CASES	580
9.11	ICPAC'S SUGGESTED CHANGES IN HSR	580
	REFERENCES	582

Chapter 10 Confidentiality Agreements and Letters of Intent	583
SCOPE	583
10.1 INTRODUCTORY PROBLEM	583
10.2 NEGOTIATING THE CONFIDENTIALITY AGREEMENT	583
10.3 WHEN DOES A LETTER OF INTENT BECOME A BINDING CONTRACT?	586
REFERENCES	593
Chapter 11 Acquisition of Stock of Closely-Held Corporation	595
SCOPE	595
11.1 PROBLEM ON STOCK ACQUISITION	595
11.2 SECURITIES LAW IMPACT	597
11.3 TAX ASPECTS	603
11.4 ACCOUNTING ASPECTS	603
11.5 HART-SCOTT-RODINO ASPECTS	604
11.6 IS THERE AN EQUAL OPPORTUNITY DOCTRINE?	604
11.7 CLAIM OF UNFAIR DEALING IN EFFECTUATING MERGER TO AVOID PAYING PREMIUM PRICE TO MINORITY SHAREHOLDERS	612
11.8 SALE OF CORPORATE OFFICE	612
11.9 IS THERE AN OBLIGATION TO INVESTIGATE THE INTENTION OF THE PURCHASER: THE LOOTING SITUATION	616
11.10 THE ALI'S PROPOSED RULES RELATING TO THE SALE OF A CONTROLLING STOCK INTEREST	619
11.11 ILLUSTRATION OF ETHICAL ISSUES ARISING IN THE SALE OF STOCK OF A CLOSELY-HELD CORPORATION	622
REFERENCES	625
Chapter 12 Acquisition of Assets of Closely-Held Corporation	627
SCOPE	627
12.1 PROBLEM ON SALE OF SUBSTANTIALLY ALL OF THE ASSETS OF A CLOSELY-HELD TARGET	627
12.2 VOTING AND DISSENTING BY TARGET'S AND ACQUIROR'S SHAREHOLDERS	629
12.3 FEDERAL SECURITIES IMPACT OF ACQUISITION OF CLOSELY-HELD TARGET'S ASSETS FOR ACQUIROR'S SECURITIES	630
12.4 TAX ASPECTS	631
12.5 ACCOUNTING ASPECTS	632
12.6 HART-SCOTT-RODINO ASPECTS	632
12.7 DUE DILIGENCE INVESTIGATION	632
12.8 POTENTIAL SUCCESSOR LIABILITY IN ASSET ACQUISITIONS	632
12.9 PURCHASING CORPORATION'S RIGHT TO ASSUME TARGET'S DEBT: IMPACT OF SUCCESSOR OBLIGOR CLAUSE IN BOND INDENTURE	640
12.10 INTRODUCTION TO THE IMPACT OF BULK SALE PROVISION	641
REFERENCES	643

Chapter 13 Acquisition of a Publicly-Held Target in a Negotiated Merger	645
SCOPE	645
13.1 PROBLEM ON ACQUISITION OF PUBLICLY-HELD TARGET IN A NEGOTIATED MERGER	645
13.2 STRUCTURING THE TRANSACTION: VOTING AND DISSENTING BY TARGET'S AND ACQUIROR'S SHAREHOLDERS	647
13.3 FEDERAL INCOME TAX ASPECTS	650
13.4 ACCOUNTING ASPECTS	650
13.5 HART-SCOTT-RODINO AND ANTITRUST ASPECTS	650
13.6 RESPONSIBILITIES OF TARGET'S AND ACQUIROR'S BOARDS OF DIRECTORS IN STRUCTURING THE TRANSACTION	651
13.7 IMPACT OF RULE 10b-5 ON DISCLOSURE OF MERGER NEGOTIATIONS	660
13.8 ISSUANCE OF SECURITIES IN RECLASSIFICATIONS, MERGERS, CONSOLIDATIONS AND ASSET ACQUISITIONS: RULE 145 AND FORM S-4	669
13.9 GUN JUMPING UNDER THE 33 ACT: THE IMPACT OF THE NEW SEC RULES GOVERNING INCREASED COMMUNICATIONS	683
13.10 THE FEDERAL PROXY RULES IN NEGOTIATED TRANSACTIONS	687
13.11 IMPLIED RIGHT OF ACTION UNDER SECTION 14(a)	696
13.12 CAUSATION UNDER SECTION 14(a)	697
13.13 ONLY NEGLIGENCE REQUIRED UNDER SECTION 14(a)	702
13.14 SCIENTER REQUIRED UNDER SECTION 14(a)	703
13.15 MERGER PROXY REQUIREMENTS UNDER STATE LAW	704
13.16 IMPACT OF SECTION 16(b)	706
13.17 ILLUSTRATION OF ETHICAL ISSUES ARISING IN PUBLIC COMPANY ACQUISITIONS	713
Chapter 14 Special Problems in Leveraged and Management Buyouts	717
SCOPE	717
14.1 INTRODUCTORY PROBLEM ON LBOs	717
14.2 INTRODUCTION TO LBOs	719
14.3 THE BUSINESS JUDGMENT RULE IN MANAGEMENT BUYOUTS	721
14.4 IMPACT OF FRAUDULENT CONVEYANCE LAW ON AN LBO	732
14.5 POTENTIAL BREACH OF FIDUCIARY DUTY TO THE CORPORATION AND ITS PRE-EXISTING CREDITORS	744
14.6 POTENTIAL LIABILITY FOR MAKING AN ILLEGAL CORPORATE DISTRIBUTION	745
14.7 POTENTIAL BREACH OF IMPLIED COVENANTS IN BOND INDENTURE OF PRE-LBO BONDHOLDERS	751
14.8 CLAIM THAT LBO UNFAIRLY HARMS CONTINUING PREFERRED SHAREHOLDERS	753
14.9 IS AN MBO STRUCTURED AS A TENDER OFFER AND FREEZEOUT MERGER A SALE OF ASSETS REQUIRING VOTE OF TARGET SHAREHOLDERS?	754
14.10 IMPACT OF FEDERAL RESERVE MARGIN REGULATIONS ON ACQUISITION FINANCING	755
REFERENCES	766

Chapter 15	Drafting Stock Purchase Agreements, Asset Acquisition Agreements, and Merger Agreements	767
	SCOPE	767
15.1	INTRODUCTORY PROBLEM ON DRAFTING ACQUISITION AGREEMENTS	768
15.2	OVERVIEW OF LEGAL CONSIDERATIONS APPLICABLE TO THE STRUCTURING OF STOCK PURCHASE AGREEMENTS, ASSET ACQUISITION AGREEMENTS, AND MERGER AGREEMENTS	769
15.3	OUTLINE OF COMMON PROVISIONS OF ACQUISITION AGREEMENTS	773
15.4	THE PARTIES TO THE TRANSACTION	774
15.5	THE WHEREAS CLAUSES	774
15.6	DEFINED TERMS	775
15.7	DESCRIPTION OF THE BASIC PURCHASE AND SALE, OR MERGER TRANSACTION	775
15.8	THE REPRESENTATIONS AND WARRANTIES: THE SNAPSHOT	775
15.9	COVENANTS: THE UNDERTAKINGS	777
15.10	CONDITIONS TO CLOSING	778
15.11	SURVIVAL OF REPRESENTATIONS AND WARRANTIES AND INDEMNIFICATION	779
15.12	TERMINATION	784
15.13	GENERAL PROVISIONS	784
15.14	LEGAL OPINIONS	784
15.15	EMPLOYMENT CONTRACTS AND NON-COMPETITION AGREEMENTS	786
15.16	REGISTRATION RIGHTS	786
15.17	DUE DILIGENCE INVESTIGATION IN CONNECTION WITH ACQUISITIONS	786
15.18	LEGALITY OF MERGER AGREEMENT PROVISION THAT PREVENTS TARGET FROM PURSUING OTHER TRANSACTIONS: ACTION BY REJECTED ACQUIROR AGAINST SUCCESSFUL ACQUIROR	790
15.19	IMPACT OF “BEST EFFORTS” AND “FIDUCIARY-OUT” PROVISIONS OF MERGER AGREEMENT	792
15.20	ACQUIROR’S ARGUMENT THAT MERGER AGREEMENT GAVE IT VESTED RIGHTS	796
15.21	1998 AMENDMENTS TO SECTION 251 OF THE DELAWARE BUSINESS CORPORATION LAW RELATING TO VAN GORKUM	796
15.22	DELAWARE’S DEVELOPING LAW ON “NO TALK” PROVISIONS OF MERGER AGREEMENTS	796
15.23	SPECIFIC PERFORMANCE OF A PUBLIC COMPANY MERGER AGREEMENT	797
	REFERENCES	799
Chapter 16	Proxy Contests	801
	SCOPE	801
16.1	INTRODUCTORY PROBLEM ON PROXY CONTESTS	801
16.2	INTRODUCTION	802
16.3	SUMMARY OF THE SEC RULES REGARDING PROXY CONTESTS AND CONSENT SOLICITATIONS	803

16.4	WHAT CONSTITUTES A “SOLICITATION” UNDER RULE 14a-1(l)?	804
16.5	SEC 1992 LIBERALIZATION OF RULES REGARDING SHAREHOLDER COMMUNICATIONS	805
16.6	ALLEGATIONS OF A FAILURE TO PROPERLY DISCLOSE UNDER RULE 14a-9	808
16.7	STATE LAW STANDARDS GOVERNING DIRECTORS’ CONTROL OF THE PROXY AND VOTING SYSTEM: BUSINESS JUDGMENT RULE, UNOCAL OR BLASIUS?	811
16.8	STATE LAW GOVERNING DEFENSIVE RESPONSE TO ACQUIROR’S CONTEMPORANEOUS TENDER OFFER AND PROXY CONTEST	816
16.9	STATE LAW RULES CONCERNING PRODUCTION OF SHAREHOLDER LISTS	820
16.10	REIMBURSEMENT OF PROXY EXPENSES UNDER STATE LAW REFERENCES	822 823
Chapter 17 Introduction to the Williams Act		825
	SCOPE	825
17.1	INTRODUCTORY PROBLEM	825
17.2	INTRODUCTION TO THE WILLIAMS ACT	826
17.3	THE LEGISLATIVE HISTORY OF THE WILLIAMS ACT AS SEEN THROUGH COURT DECISIONS	829
17.4	SEC’S ADVISORY COMMITTEE ON TENDER OFFERS REFERENCES	831 833
Chapter 18 Regulation of Open Market Purchases		835
	SCOPE	835
18.1	INTRODUCTORY PROBLEMS ON SECTION 13(d)	835
18.2	REGULATION OF OPEN MARKET PURCHASES	836
18.3	AVAILABILITY OF INJUNCTIVE RELIEF	838
18.4	TARGET’S STANDING UNDER §13(d)	840
18.5	DEGREE OF DISCLOSURE REQUIRED IN A SCHEDULE 13D STATEMENT	844
18.6	AMENDMENTS	846
18.7	THE GROUP CONCEPT REFERENCES	847 852
Chapter 19 Definition of Tender Offer		853
	SCOPE	853
19.1	INTRODUCTORY PROBLEM ON THE DEFINITION OF TENDER OFFER	853
19.2	DEFINITION OF TENDER OFFER: THE CASE LAW	854
19.3	SEC’S PROPOSED (AND WITHDRAWN) DEFINITION OF TENDER OFFER	866
19.4	SEC’S PROPOSED RULES ON MARKET SWEEPS REFERENCES	867 868

Chapter 20	Third Party Tender Offers: The SEC's Rules	
	Under Sections 14(d) and (e)	869
	SCOPE	869
20.1	INTRODUCTORY PROBLEM ON THIRD PARTY TENDER OFFERS	869
20.2	INTRODUCTION TO THE RULES	870
20.3	BASIC RULES GOVERNING THE BIDDER	872
20.4	BASIC RULES GOVERNING THE TARGET	910
20.5	UNLAWFUL TENDER OFFER PRACTICES: RULE 14e-3: TRANSACTIONS IN SECURITIES ON THE BASIS OF MATERIAL NONPUBLIC INFORMATION IN THE CONTEXT OF TENDER OFFERS	916
20.6	RULES RELATING TO TARGET'S SHAREHOLDERS: PROHIBITION AGAINST SHORT TENDERING UNDER RULE 10b-4	922
20.7	ACTIONS UNDER SECTION 14(e)	924
20.8	LEGAL ACTIONS UNDER SECTION 14(d)	928
20.9	DUTY TO DISCLOSE SOFT INFORMATION IN THE CONTEXT OF A TENDER OFFER: IMPACT OF RULE 10b-5 AND SECTION 14(e)	931
20.10	SEC'S ADVISORY COMMITTEE ON TENDER OFFERS	935
20.11	PROPOSALS TO DETER HOSTILE TAKEOVERS AND LBOS	937
20.12	ILLUSTRATION OF ETHICAL ISSUES ARISING IN A TENDER OFFER	938
	REFERENCES	941
Chapter 21	SEC's Rules on Tender Offers by Issuers	943
	SCOPE	943
21.1	INTRODUCTORY PROBLEM ON ISSUER TENDER OFFERS	943
21.2	WHAT IS AN ISSUER TENDER OFFER?	944
21.3	SEC'S EXPLANATION OF RULE 13e-4 AND SCHEDULE 13E-4, NOW SCHEDULE TO	944
21.4	AMENDMENT RELATING TO ODD LOT OFFERS	946
21.5	RULE 10b-18 SAFE HARBOR FROM LIABILITY FOR MANIPULATION IN IS- SUER PURCHASE TRANSACTION	947
	REFERENCE	948
Chapter 22	State Regulation of Tender Offers	949
	SCOPE	949
22.1	INTRODUCTORY PROBLEMS ON STATE TAKEOVER STATUTES	949
22.2	THE FIRST GENERATION STATUTES: THE SUPREME COURT'S VIEW OF THE ILLINOIS STATUTE	950
22.3	THE SECOND GENERATION STATUTES: THE SUPREME COURT'S VIEW OF THE INDIANA CONTROL SHARE STATUTE	952
22.4	THE THIRD GENERATION STATUTES	954
22.5	PENNSYLVANIA'S SECOND AND THIRD GENERATION STATUTES AND BEYOND	962
22.6	THE VIRGINIA APPROACH: CONTROL SHARE ACT, AFFILIATED TRANSACTIONS ACT, POISON PILL ACT, AND BUSINESS JUDGMENT STATUTE	969
22.7	OTHER CONSTITUENCY STATUTES	973
22.8	POLICY PERSPECTIVES: THREE VIEWS OF THE ECONOMIC EFFECT OF STATE TAKEOVER LEGISLATION	974

Chapter 23	Target's Defensive Actions	977
	SCOPE	977
23.1	INTRODUCTORY PROBLEM ON DEFENSIVE TACTICS	977
23.2	GENERAL APPLICATION OF THE BUSINESS JUDGMENT RULE IN TAKEOVER TRANSACTIONS	979
23.3	APPLICATION OF THE UNOCAL AND BLASIUS STANDARD GENERALLY	979
23.4	DUTY TO HOLD AN AUCTION	984
23.5	POISON PILLS	987
23.6	THE "JUST SAY NO" DEFENSE	1009
23.7	SHARK REPELLENT PROVISIONS: CHARTER AND BYLAW PROVISIONS DESIGNED TO PREVENT TAKEOVERS AND PROTECT PILLS	1010
23.8	GOLDEN PARACHUTE PAYMENTS	1034
23.9	GREENMAIL	1037
23.10	POISON DEBT	1039
23.11	THREE OPPOSING VIEWS ON DEFENSIVE TACTICS	1041
23.12	ALI's PROPOSED RULES GOVERNING DEFENSIVE TACTICS	1045
23.13	SEC's ADVISORY COMMITTEE ON TENDER OFFERS	1045
23.14	ILLUSTRATION OF ETHICAL ISSUES ARISING IN CONNECTION WITH DEFENSIVE TACTICS	1047
	REFERENCES	1048
Chapter 24	Second Step and Freezeout Mergers	1049
	SCOPE	1049
24.1	INTRODUCTORY PROBLEM ON FREEZEOUTS	1049
24.2	INTRODUCTION TO FREEZEOUT TRANSACTIONS	1050
24.3	ILLUSTRATION OF PROBLEM WITH LESS THAN WHOLLY OWNED SUBSIDIARIES: THE ENTIRE FAIRNESS TEST	1051
24.4	CORPORATE MECHANICS IN SECOND STEP AND FREEZEOUT MERGERS	1051
24.5	REQUIREMENT OF SUBSTANTIVE FAIRNESS IN DELAWARE	1052
24.6	DELAWARE SUPREME COURT'S REAFFIRMATION OF THE ENTIRE FAIRNESS DOCTRINE	1053
24.7	ELABORATION ON WEINBERGER	1053
24.8	CONTINUING IMPACT OF BUSINESS PURPOSE DOCTRINE	1056
24.9	THE ALI's PROPOSED RULES RELATING TO FREEZEOUT MERGERS	1057
24.10	POTENTIAL APPLICABILITY OF RULE 10b-5 TO SECOND STEP AND FREEZEOUT MERGERS	1062
24.11	THE SEC's GOING PRIVATE RULES	1064
24.12	APPLICABILITY OF REGULATION 14C, RULES 14c-1 THROUGH 14c-7 AND SCHEDULE 14C TO FREEZEOUT MERGERS	1074
24.13	APPLICABILITY OF PROXY RULES TO FREEZEOUT MERGERS	1076
	REFERENCES	1078

Chapter 25 Spinoffs	1079
SCOPE	1079
25.1 INTRODUCTORY PROBLEM ON SPINOFFS	1079
25.2 FEDERAL INCOME TAX IMPACT ON SPINOFFS	1080
25.3 CORPORATE ISSUES IN SPINOFFS	1082
25.4 FEDERAL SECURITIES ISSUES RELATING TO SPINOFFS	1085
25.5 PROXY STATEMENT IN ITT SPINOFF	1089
REFERENCES	1089
Chapter 26 International Acquisitions	1091
SCOPE	1091
PART I - INTRODUCTION	1093
26.1 INTRODUCTORY PROBLEM ON CROSS BORDER ACQUISITIONS	1093
26.2 INTRODUCTION TO CROSS BORDER ACQUISITIONS	1094
PART II - INBOUND ACQUISITIONS	
Acquisition by Foreign Acquirors of U.S. Targets	1095
26.3 U.S. CORPORATE ISSUES IN INBOUND ACQUISITIONS	1095
26.4 FEDERAL SECURITIES ISSUES IN INBOUND ACQUISITIONS	1096
26.5 IMPACT OF FEDERAL INCOME TAX ON INBOUND ACQUISITIONS	1096
26.6 ANTITRUST ASPECTS OF INBOUND ACQUISITIONS	1098
26.7 EXON-FLORIO	1099
PART III - OUTBOUND ACQUISITIONS, SECTION A	
U.S. and Foreign Corporate and Securities Issues	
in Outbound Acquisitions	1103
26.8 THE EC'S DIRECTIVES ON MERGERS AND TAKEOVERS AND THE OECD'S PRINCIPLES OF CORPORATE GOVERNANCE	1103
26.9 REGULATION OF NEGOTIATED MERGERS AND TAKEOVERS IN THE U.K.	1115
26.10 REGULATION OF NEGOTIATED MERGERS AND TAKEOVERS IN GERMANY	1127
26.11 REGULATION OF NEGOTIATED MERGERS AND TAKEOVERS IN FRANCE	1130
26.12 FEDERAL SECURITIES LAWS ISSUES IN ACQUISITIONS OF FOREIGN TARGETS	1133
PART III - OUTBOUND ACQUISITIONS, SECTION B	
U.S. and Foreign Tax Issues in Outbound Acquisitions	1141
26.13 IMPACT OF FEDERAL INCOME TAXATION ON OUTBOUND ACQUISITIONS	1141
26.14 THE EC DIRECTIVE ON INCOME TAX ASPECTS OF MERGERS, ASSET ACQUISITIONS AND SHARE EXCHANGE	1141
26.15 TAX TREATMENT OF MERGERS, ASSET ACQUISITIONS AND SHARE EXCHANGES IN THE U.K.	1145
26.16 TAX TREATMENT OF MERGERS, ASSET ACQUISITIONS AND SHARE EXCHANGES IN GERMANY	1146
26.17 TAX TREATMENT OF MERGERS, ASSET ACQUISITIONS AND SHARE EXCHANGES IN FRANCE	1146

PART III - OUTBOUND ACQUISITIONS, SECTION C		
U.S. and Foreign Antitrust Issues in Outbound Acquisitions		1147
26.18	ANTITRUST REGULATION OF MERGERS AND ACQUISITIONS IN THE EUROPEAN COMMUNITY (EC)	1147
26.19	ANTITRUST MERGER ENFORCEMENT IN THE U.K.	1158
26.20	ANTITRUST MERGER ENFORCEMENT IN GERMANY	1164
26.21	ANTITRUST MERGER ENFORCEMENT IN FRANCE	1168
26.22	IMPACT OF SUBSTANTIVE U.S. ANTITRUST LAW AND HART-SCOTT-RODINO PRE-MERGER NOTIFICATION ON INTERNATIONAL ACQUISITIONS	1170
26.23	NEED FOR CONVERGENCE IN ANTITRUST POLICY	1173
PART III - OUTBOUND ACQUISITIONS, SECTION D		
Foreign Investment Restrictions in Outbound Acquisitions		1179
26.24	RESTRICTIONS ON INVESTMENT	1179
PART III - OUTBOUND ACQUISITIONS, SECTION E		
International Accounting Standards for Mergers and Acquisitions		1180
26.25	INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (IASC) RULES ON BUSINESS COMBINATIONS AND INTANGIBLES	1180
PART III - OUTBOUND ACQUISITIONS, SECTION F		
Case Study: Acquisition by US Acquiror of South African Public Target		1181
26.26	CASE STUDY: ACQUISITION BY U.S. ACQUIROR OF SOUTH AFRICAN PUBLIC TARGET	1181
	REFERENCES	1199
Chapter 27 Acquisitions of Banks and Bank Holding Companies: Impact of the New Financial Holding Company		1201
	SCOPE	1201
27.1	INTRODUCTORY PROBLEM ON BANK ACQUISITIONS	1202
27.2	BASIC MERGER AND ACQUISITION PRINCIPLES	1202
27.3	STATE AND FEDERAL CHARTERING	1204
27.4	IMPACT OF NATIONAL BANK ACT AND BANK MERGER ACT ON CONSOLIDATION OF NATIONAL BANK WITH ANOTHER NATIONAL BANK OR WITH A STATE BANK.	1205
27.5	CHANGE IN BANK CONTROL ACT	1211
27.6	THE GLASS-STEAGALL ACT: PARTIAL REPEAL BY THE GRAMM-LEACH-BLILEY ACT	1213
27.7	BANK HOLDING COMPANIES GENERALLY	1214
27.8	ACQUISITIONS INVOLVING BANK HOLDING COMPANIES, FINANCIAL HOLDING COMPANIES, AND BANK OPERATING SUBSIDIARIES	1220
27.9	RIEGLE-NEAL INTERSTATE BANKING AND BRANCHING EFFICIENCY ACT OF 1994	1232
27.10	BACKGROUND INFORMATION ON 1992 ACQUISITION BY BANKAMERICA OF SECURITY PACIFIC	1236
27.11	CONSIDERATION OF CAPITAL ADEQUACY IN APPLICATIONS FOR MERGERS AND ACQUISITIONS OF BANK HOLDING COMPANIES	1238

27.12	CONSIDERATION OF MANAGERIAL RESOURCES AND FUTURE PROSPECTS IN APPLICATIONS FOR MERGERS OR ACQUISITIONS OF BANK HOLDING COMPANIES	1242
27.13	CONSIDERATION OF THE CONVENIENCE AND NEEDS OF THE COMMUNITY IN APPLICATIONS FOR MERGERS OR ACQUISITIONS OF BANK HOLDING COMPANIES	1243
27.14	ANALYSIS OF NONBANKING ACTIVITIES IN BANKAMERICA'S 1992 ACQUISITION OF SECURITY PACIFIC	1244
27.15	ANTITRUST ANALYSIS IN MERGERS AND ACQUISITIONS OF BANK HOLDING COMPANIES	1244
27.16	INTERNATIONAL BANK ACQUISITIONS: WORLD TRADE ORGANIZATION NEWS RELEASE	1250
	REFERENCES	1250
Chapter 28 Introduction to Issues in Telecommunications Mergers and Acquisitions		1251
	SCOPE	1251
28.1	INTRODUCTORY PROBLEM	1252
28.2	INTRODUCTION TO THE ISSUES	1252
28.3	MERGERS INVOLVING ACQUISITIONS OF TELEPHONE COMPANIES AND CELLULAR COMPANIES	1254
28.4	MERGERS IN THE BROADCAST INDUSTRY	1270
28.5	CABLE OWNERSHIP ISSUES	1286
28.6	INTERNATIONAL ISSUES	1300
28.7	THE AOL TIME WARNER MERGER: A CASE STUDY	1305
	REFERENCES	1309
Chapter 29 Introduction to Joint Ventures and Strategic Alliances: An Alternative to Merger		1311
	SCOPE	1311
29.1	INTRODUCTORY PROBLEM	1311
29.2	BUSINESS ASPECTS OF JOINT VENTURES	1312
29.3	FEDERAL INCOME TAX ASPECTS OF PARTNERSHIP AND LLC JOINT VENTURES	1312
29.4	A GUIDE TO PARTNERSHIP LAW ASPECTS OF JOINT VENTURES	1313
29.5	A GUIDE TO LLC LAW ASPECTS OF JOINT VENTURES	1333
29.6	ANTITRUST ANALYSIS OF JOINT VENTURES	1337
29.7	FORMATION OF INTERNATIONAL JOINT VENTURES	1349
	REFERENCES	1365

Table of Cases

- AC Acquisitions v. Anderson, Clayton & Co., 979
- ACE Limited v. Capital Re Corporation, 654
- Adams v. Standard Knitting, 703
- Allegheny Energy v. DQE, Inc., 797
- Allen v. Prime Computer, Inc., 1017
- Amalgamated Sugar Co. v. NL Industries, 988
- Amanda Acquisition Corp. v. Universal Foods Corp., 954
- AMP Incorporation v. AlliedSignal Corporation, 968, 819, 1007
- Anago, Inc. v. Tecnol Medical Products, Inc., 537
- Appelstein v. United Board and Carton Corp., 190
- Arkansas Best Corp. v. Pearlman, 908
- Armstrong World Industries, Inc. v. Adams, 962
- Arnold v. Society for Savings Bancorp, Inc., 52, 123, 131
- Aronson v. Lewis, 40
- Barkan v. Amsted Industries, Inc., 725
- Basic, Inc. v. Levinson, 281, 662
- Bernard v. Kee Mfg. Co., Inc., 637
- Birnbaum v. Newport Steel Corp., 597
- Blasius Industries, Inc. v. Atlas Corp., 111
- Blue Chip Stamps v. Manor Drug Stores, 598
- Bove v. Community Hotel Corp. of Newport, Rhode Island, 209
- Boxer v. Husky Oil Company, 1323
- Brazen v. Bell Atlantic Corporation, 652
- Brown Shoe Co. v. United States, 415, 417
- Caesars World, Inc. v. Sosnoff, 764
- Caplan v. Lionel Corp., 612
- Cargill, Inc. v. Monfort of Colorado, Inc., 535
- Cede & Co. v. Technicolor, Inc., 55, 172
- Cede & Co., and Cinerama, Inc. v. Technicolor, Inc., 168
- Centaur Partners, IV v. National Inter-group, Inc., 1013
- Chaffin v. GNI Group, Inc, 66
- Cheff v. Mathes, 87
- Chesapeake Corporation v. Shore, 960, 1021
- Chris-Craft Industries, Inc. v. Bangor Punta Corp., 240
- Cinerama, Inc. v. Technicolor, Inc., 58, 61
- City Capital Associates Limited Partnership v. Interco Inc., 992
- Clearfield Bank and Trust Company v. Omega Financial Corporation, 920
- CNW Corp. v. Japonica Partners, L.P., 810
- Coggins v. New England Patriots Football Club, Inc., 1056
- Colan v. Mesa Petroleum Co., 709
- ConAgra, Inc. v. Cargill, Incorporated, 792
- ConAgra, Inc. v. Tyson Foods, Inc., 804
- Consolidated Gold Fields PLC v. Minorco, S.A., 1139
- CRTF Corporation v. Campeau Corp., 987
- CTS Corp. v. Dynamics Corp. of America, 952
- Dart v. Kohlberg, Kravis, Roberts & Co., 753
- Ditty v. Checkrite, Ltd., Inc., 1336
- Edgar v. Mite Corp., 950
- Electronic Specialty Co. v. International Controls Corp., 829

- Emerald Partners v. Berlin*, 84
Epstein v. MCA, Inc., 887
Equity Group Holdings v. DMG, Inc., 197
Ernst & Ernst v. Hochfelder, 274
Essex Universal Corp. v. Yates, 613
Ex Parte NBSA Centre Ltd, 1194
Ex Parte Garlick Ltd, 1196
Farris v. Glen Alden Corp., 185
Feit v. Leasco Data Processing Equipment Co., 246
Feldman v. Simkins Industries, Inc., 847
Field v. Trump, 884
Field v. Allyn, 754
Fin Hay Realty Co. v. United States, 295
Florida Commercial Banks v. Culverhouse, 840
Flynn v. Bass Brothers Enterprises, Inc., 931
Foremost-McKesson, Inc. v. Provident Securities Company, 707
Francis I. DuPont & Co. v. Universal Studios, 166
FTC v. University Health, Inc., 527
FTC v. Staples, Inc., 514
FTC v. The Proctor & Gamble Company, 526
GAF Corp. v. Heyman, 808
GAF Corp. v. Milstein, 830, 847
Georgia-Pacific Corp. v. Great Northern Nekoosa Corp., 989
Gerdes v. Reynolds, 616
Gimbel v. The Signal Companies, Inc., 40, 180
Giuffrida v. American Family Brands, Inc., 781
Glamorgan Coal Corp. v. Ratner's Group PLC, 263
Goldberg v. Meridor, 1062
Gould v. American-Hawaiian S.S. Co., 702
Grand Metropolitan PLC v. The Pillsbury Company, 996
Grossman v. Novell, Inc., et al., 239
Guth v. Loft, Inc., 36
Hanson Trust PLC v. SCM Corp., 830, 864
Hanson Trust PLC v. MI SCM Acquisition, Inc., 68
Hariton v. Arco Electronics, Inc., 184
HB Korenvaes Investments, L.P. v. Marriott Corporation, 38
Hilton Hotels Corporation v. ITT Corporation, 1015, 1019
Howing Co. v. Nationwide Corp., 1070, 1073, 1076
In Boeing Company, 487
In Matter of Merry Land & Investment Co., Inc., 846
In Re C-T of Virginia, Incorporated v. Barrett, 746
In Re Chrysler Corporation Shareholder's Litigation, 990
In Re Daisy Systems Corporation, 400
In Re Gaylord Container Corporation Shareholders Litigation, 1030
In Re Genentech, Inc. Shareholders Litigation, 704
In Re IXC Communications, Inc. Shareholders Litigation v. Cincinnati Bell, Inc., 658
In Re Kaiser Steel Corporation, Kaiser Steel Corporation v. Pearl Brewing Co., 741
In Re Munford, Inc. v. Valuation Research Corporation, 748
In Re Santa Fe Pacific Shareholder Litigation, 135
In Re The O'Day Corporation v. Meritor Savings Bank, 738
In Re Time Incorporated Shareholder Litigation, 394
In Re Cencom Cable Income Partners, L.P. Litigation, 1331
In the Matter of Carnation Company, 660
In the Matter of George C. Kern, Jr. (Allied Stores Corp.), 912
In the Matter of Meyers Parking System, Inc., 1071
In the Matter of the Appraisal of Ford Holdings, Inc. Preferred Stock, 173
In the Matter of the Boeing Company/McDonnell Douglas Corporation, 486
International Brotherhood of Teamsters General Fund v. Fleming Companies, Inc., 814
Invacare Corporation v. Healthdyne Technologies, Inc., 1001
Irving Bank Corporation v. Board of Governors of the Federal Reserve System, 1241
Irving Bank Corp. v. Bank of New York Co., Inc., 192
IU International Corp. v. NX Acquisition Corp., 929

- Ivanhoe Partners v. Newmont Mining Corp., 985
- J.I. Case Company v. Borak, 696
- Jedwab v. MGM Grand Hotels, Inc., 37
- Jewel Companies, Inc. v. Pay Less Drug Stores Northwest, Inc., 790
- Jones v. H.F. Ahmanson & Company, 606
- Jordan v. Duff and Phelps, Inc., 602
- K-N Energy, Inc. v. Gulf Interstate Co., 844
- Kahn v. Lynch, 82, 125
- Kahn v. Lynch Communications Systems, Inc., 78, 1052
- Kahn v. Dairy Mart Convenience Stores, Inc., 726
- Katz v. Bregman, 182
- Kern County Land Co. v. Occidental Petroleum Corp., 708
- Keyser v. Commonwealth National Financial, 651
- Kirsch Co. v. Bliss and Laughlin Industries, Inc., 843
- Kirschner Bros. Oil, Inc. v. Natomas Co., 213
- Klang v. Smith's Food & Drug Centers, Inc., 750
- Klapmeier v. Telecheck International, Inc., 253
- Knapp v. North American Rockwell Corp., 632
- Kramer v. Time-Warner, Inc., 893
- Landreth Timber Company v. Landreth, 599
- Lerro v. Quaker Oats Company, 891
- Loudon v. Archer Daniels-Midland Company, 124
- Lutz v. Boas, 36
- MAI Basic Four, Inc., v. Prime Computer, Inc., 906
- Mellon Bank N.A. v. Metro Communicators, Inc., 736
- Metropolitan Life Insurance Company v. RJR Nabisco, Inc., 751
- Meyer V. Goldman Sachs & Co., 397
- Mills Acquisition Co. v. Macmillan, Inc., 721
- Mills v. Electric Auto-Lite Company, 697
- Moore Corporation Limited Inc. v. Wallace Computer Services, Inc., 132
- Moran v. Household International, Inc., 96
- Munford Inc., v. Valuation Research Corporation, 742
- Nationwide Cellular Service, Inc. v. American Mobile Communications, Inc., 630
- NBT Bancorp Inc., v. Fleet/Norstar Financial Group, Inc., 794
- NCR Corp. v. American Tel. and Tel. Co., 818
- Nelson v. Paramount Communications, Inc., 666
- NoDak Bancorporation v. Clark, et al., 1208
- Norfolk Southern Corporation v. Conrail Inc., 963, 966
- Orzeck v. Englehart, 189
- Panter v. Marshall Field & Co., 88
- Paramount Communications, Inc. v. Time Inc., 103
- Paramount Communications, Inc. v. QVC Network, Inc., 114
- Parnes v. Bally Entertainment Corporation, 34, 65
- Perlman v. Feldmann, 604
- Phelps Dodge Corporation v. Cyprus Amax Minerals Company, 653
- Phillips v. LCI International, Inc., 667
- Piper v. Chris-Craft Industries, Inc., 924
- Polaroid Corp., v. Disney, 927, 928
- Polk v. Good, 1037
- Puma v. Marriott, 39
- Quickturn Design Systems, Inc. v. Shapiro, 1003
- Rabkin v. Philip A. Hunt Chemical Corporation, 1054
- Randall v. Bailey, 1083
- Rauch v. RCA Corporation, 207
- Reliance Electric Co. v. Emerson Electric Co., 706
- Revlon, Inc. v. MacAndrews & Forbes Holdings, 100
- Revlon, Inc. v. Pantry Pride, Inc., 761
- Rondeau v. Mosinee Paper Corp., 838
- Rosales v. Thermex-Thermatron, Inc., 635
- Rosenblatt v. Getty Oil Co., 1053
- Rosenfeld v. Fairchild Engine and Airplane Corp., 822
- Roven v. Cotter, 1018
- S-G Securities, Inc. v. Fuqua Investment Co., 854
- S.I. Management L.P. v. Wininger, 1315
- Sadler v. NCR Corp., 820
- Santa Fe Industries, Inc. v. Green, 275

- Scattergood v. Perelman, 701
Schneider v. Lazard Frères & Co., 395
Schnell v. Chris-Craft Industries, Inc., 111
Schreiber v. Burlington Northern, Inc., 831, 925
SEC v. First City Financial Corp., 843, 851
SEC v. Carter Hawley Hale Stores, Inc., 860
Securities and Exchange Commission v. Mayhew, 919
Shamrock Holdings, Inc. v. Polaroid Corp., 982
Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 640
Sheinberg v. Fluor Corp., 905
Shidler v. All American Life & Financial Corporation, 202
Sinclair Oil Corporation v. Levien, 70
Skycom Corporation v. Telstar Corporation, 591
Smith v. Van Gorkom, 41
Stahl v. Apple Bancorp, Inc. (Stahl I), 811
Stahl v. Apple Bancorp (Stahl II), 816
Starkman v. Marathon Oil Co., 933
State of New York v. Kraft General Foods, Inc., 512
Steinberg v. Amplica, Inc., 218
Sterling v. Mayflower Hotel Corporation, 70
Strauss v. American Holdings, Inc., 711
Stroud v. Grace, 813
Stuchen v. Duty Free International, Inc., 397
Swinney v. Keebler Company, 618
Tate & Lyle PC v. Staley Continental Inc., 1012
Tate & Lyle PLC v. Staley Continental, Inc., 1034
Terry v. Penn Central Corporation, 195
Texaco, Inc. v. Pennzoil Co., 586
The Bank of New York Company, Inc. v. Irving Bank Corporation, et al., 999
Thorpe v. CERBCO, Inc., 608
Time Warner Entertainment Co., L.P. v. United States of America, 1295
TSC Industries, Inc. v. Northway, 279
TW Services Inc. v. SWT Acquisition Corporation, 998
U.S. West, Inc. v. Time Warner, Inc., 1325
U.S. v. Archer-Daniels-Midland Company, 484
United States v. O'Hagan, 917
United States v. E.I. Du Pont de Nemours and Co., 489
United States v. Microsoft Corporation, 411
United States Cellular Investment Company of Allentown v. Bell Atlantic Mobile Systems, Inc., 1324
United States v. Philadelphia National Bank, 420
United States v. Baker Hughes Inc., 520
United States v. Von's Grocery, Co., 423
United States v. O'Hagan, 277
United States v. General Dynamics, 425
United States v. Capstar Broadcasting Corporation Proposed Final Judgment and Competitive Impact Statement, 1285
Unitrin, Inc. v. American General Corp., 126
Unocal Corporation v. Mesa Petroleum Co., 89
Virginia Bankshares, Inc. v. Sandberg, 698
Warner Communications, Inc. v. Murdoch, 850
Warner Communications, Inc. v. Chris-Craft Industries, Inc., 200
Weinberger v. UOP, Inc., 71, 167, 171
Weinberger v. Jackson, 249
Wellman v. Dickinson, 849, 855
West Shore Fuel, Inc. v. United States, 292
Wieboldt Stores, Inc. v. Schottenstein, 734, 744, 745
Williams v. Grier, 1027
Wilmington Leasing, Inc. v. Parrish Leasing Company, L.P., 1316
Wilson v. Friedberg, 1319
WLR Foods, Inc. v. Tyson Foods, Inc., 969
Wyser-Pratte v. Van Dorn Company, 823
Young v. Valhi Inc., 1012
Zetlin v. Hanson Holding, Inc., 607
Zirn v. VLI Corporation, 705

Preface to the Second Edition

This edition follows the format of the first edition with the following major additions: (1) Section 26.26, *A Case Study of an Acquisition by US Acquiror of a South African Target*, of Chapter 26, International Acquisitions; (2) Chapter 28, Introduction to Issues in Telecommunications Mergers and Acquisitions; and (3) Chapter 29, Introduction to Joint Ventures and Strategic Alliances: An Alternative to Merger. The materials have been updated through November 2000.

I thank Cecil Wray, Richard Hoskins and Frank Balotti for their helpful comments on the first edition and suggestions for improvements and Thomas Krattenmaker and Lilly Levy for their comments on Chapter 28, Introduction to Issues in Telecommunications Mergers and Acquisitions. Section 26.26, *A Case Study of an Acquisition by US Acquiror of a South African Target*, is based on some of the materials covered in a course I taught at the University of Pretoria Law School in South Africa on Comparative Merger & Acquisition Law and Regulation: South Africa, The EU, and the US. I thank the following South Africans for their assistance in that course: Richard Connellan, Securities Regulation Panel; Professor PA Delpont, University of Pretoria; Nkonzo Hlatshwayo, Competition Commission; Michael Katz, Edward Nathan & Friedland; Dave Thayser, Ernst & Young, Corporate Finance; and Kosie Louw, Franz Tomasek and Johan de la Rey of the South African Revenue Service. I also thank Byron Stith, my research assistant at the University of Miami Law School, and Catherin Curry, my able administrative assistant. Finally, thanks to my wife, Barbara Gothard-Thompson, for her moral support, encouragement, and patience.

Samuel C. Thompson, Jr.
Coral Gables, Florida
November 27, 2000

Preface to the First Edition

The Genesis of the Book

The principal purpose of this book is to help train law students in the art of doing merger and acquisition deals. This book had its genesis in several of the courses I had as a student at the University of Pennsylvania School of Law 25 years ago. Those courses excited my interest in mergers and acquisitions. The book is, therefore, appropriately dedicated to my Penn professors who introduced me to the topics addressed here: Professors Robert H. Mundheim, Bernard Wolfman, David S. Ruder, Louis B. Schwartz and Martin J. Aronstein.

I was first exposed to mergers and acquisitions by Professor Mundheim in my second year Corporations course. That course, undoubtedly one of the best Corporations courses ever offered, opened my eyes to the fascinating world of corporate and securities law. In that course, I first read many of the cases examined in this book (such as *Farris v. Glen Alden*, see Chapter 3).

Icing on the cake was provided by Visiting Professor David Ruder in his Securities Regulations course and Rule 10b-5 seminar. I distinctly remember studying SEC Rule 133, which has now been replaced by Rule 145 (see Chapter 13) in Professor Ruder's Securities Regulations course. His Rule 10b-5 seminar, which was by far the best seminar I have experienced, explored in depth topics addressed at several points in this book (see Chapters 4, 13 and 20).

Dean Wolfman's Corporate Tax course introduced me to taxable acquisitions and tax-free reorganizations (see Chapter 5). Indeed, after I finished Professor Mundheim's Corporations course, I was certain that I wanted to be a corporate and securities lawyer, but Dean Wolfman sent me off in the direction of the tax law, which I have pursued for most of my career. In this book, I return to my roots in Professor Mundheim's Corporations course, and also explore other merger and acquisition topics that piqued my interest at Penn, such as tax, antitrust, and accounting.

Professor Louis Schwartz introduced me to antitrust law and to Section 7 of the Clayton Act (see Chapter 8). Even though the law under Section 7 has changed significantly in the past 25 years, the foundation Professor Schwartz provided has helped me in trying to understand the evolving landscape of Section 7.

Finally, the ideas explored in several chapters can be traced to Professor Aronstein, who introduced me to purchase and pooling accounting (see Chapter 6) in his Legal Accounting course and to fraudulent conveyance law in his Creditor Rights course. Fraudulent conveyance law has become important in LBOs (see Chapter 14), which were not nearly as visible when I first studied Creditor Rights.

I am greatly indebted to Penn Law and the great education I received there. Apart from my parents, Penn Law is the best thing that has happened to me. Indeed, it set me on a path I could not before Penn have ever dreamed of. It is my privilege to publicly thank Professors Mundheim, Wolfman, Ruder, Aronstein, and all my other great professors at Penn Law.

About the Book

The book provides a transactional approach to many of the issues that arise in mergers and acquisitions, including corporate, securities, antitrust, Federal income taxation,

accounting, and valuation. In addressing corporate topics, consideration is given principally to Delaware corporate law, the Revised Model Business Corporate Act, and the American Law Institute's 1994 Principles of Corporate Governance.

Reference is made throughout the book to the 1989 transaction in which Time, Inc. acquired Warner Communications, Inc. This transaction presented many of the issues that can arise in mergers and acquisitions, including (1) a negotiated merger in which Time was going to acquire Warner in a reverse subsidiary stock for stock merger, (2) a hostile cash tender offer by Paramount Communications, Inc. for Time, (3) a responsive friendly tender offer by Time for Warner, and (4) a freezeout merger in which Time acquired the stock of Warner not acquired in its original tender offer. Many of the documents in the Time-Warner transaction, including the original merger agreement, are set out in the Appendices. The Appendices also contain other sample acquisition documents, including a sample stock purchase agreement and a sample asset purchase agreement.

The book is divided into four parts:

- Part I, The Building Blocks,
- Part II, Consensual Transactions,
- Part III, Hostile Transactions, and
- Part IV, Special Topics.

Part I, the Building Blocks, looks at issues likely to be faced in both consensual and hostile transactions. Part I opens with a look at the duties of directors in mergers and acquisitions as developed in such cases as *Van Gorkom*, *Unocal* and *Revlon* (Chapter 2). This part then turns to the shareholders' right to vote and appraisal under state corporate law and under the ALI's Principles of Corporate Governance (Chapter 3). Basic issues in securities regulation are then considered. Here the focus is principally on the registration requirement of Section 5 of the Securities Act of 1933, the Reg. D private offering exemption, and the Rule 144 resale exemption (Chapter 4). The next two chapters focus on Federal income taxation of acquisitions, including an introduction to both taxable and tax free acquisitions (Chapter 5) and purchase and pooling accounting (Chapter 6). These chapters refer to the tax and accounting treatment of (1) the original stock for stock merger between Time and Warner, which was structured as a tax-free reorganization with pooling of interest accounting treatment, and (2) the final freezeout merger in which Time completed its acquisition of Warner, which was structured as a taxable stock acquisition with purchase accounting treatment.

Part I then turns to an examination of modern valuation techniques used in mergers and acquisitions, including the discounted cash flow technique, the capital asset pricing model, and the weighted average cost of capital (Chapter 7). The next two chapters examine substantive antitrust analysis under Section 7 of the Clayton Act, including consideration of the 1992 Horizontal Merger Guidelines of the Department of Justice and Federal Trade Commission (Chapter 8), and pre-merger notification under the Hart-Scott-Rodino Act (Chapter 9). The last chapter in Part I focuses on confidentiality agreements and letters of intent (Chapter 10), which may be entered into prior to the execution of the acquisition agreement.

Part II, Consensual Transactions, looks at several basic forms of acquisition transactions. This part opens with an examination of acquisitions of the stock of closely-held corporations (Chapter 11) followed by a look at acquisitions of the assets of closely-held corporations (Chapter 12) and at acquisitions of publicly-held corporations by merger (Chapter 13). This latter chapter considers such topics as the impact of SEC Rule 145 on the issuance of securities in a negotiated acquisition, the role of the SEC proxy rules, and the impact of Section 16(b) of the Securities Exchange Act of 1934, which regulates short-

swing insider trading. Part II then looks at leveraged buy-outs (Chapter 14), which can raise a variety of special issues, including fraudulent conveyance concerns and the impact of the Federal Reserve Board's margin regulations. The last chapter in Part II focuses on the drafting of various forms of acquisition agreements (Chapter 15).

Part III, Hostile Transactions, considers both the state and federal law governing hostile acquisitions. This part opens with a look at proxy contests (Chapter 16) and then turns to an introduction to the Williams Act, which added the tender offer provisions to the Securities Exchange Act of 1934 (Chapter 17). Several chapters then examine the following aspects of the Williams Act: The regulation of open market purchases under Section 13(d) of the Williams Act (Chapter 18); the meaning of the term "tender offer," which is not defined by the Williams Act (Chapter 19); the regulation of third party tender offers under Sections 14(d) and (e) of the Williams Act (Chapter 20); and the regulation of issuer tender offers under Section 13(e) of the Williams Act (Chapter 21). Part III then looks at state regulation of tender offers, including an examination of the impact of Pennsylvania corporate law on the competing bids by CSX and Norfolk Southern for Conrail (Chapter 22) and state regulation of defensive tactics employed by a target's management, such as the poison pill, greenmail, and golden parachutes (Chapter 23). Part III ends with an examination of second-step freezeout mergers (Chapter 24).

Part IV, Special Topics, considers three important and current topics. The part starts with a look at spinoffs, which are transactions in which a parent corporation distributes the stock of a subsidiary to the parent's shareholders (Chapter 25). These transactions may take place prior to an acquisition. Part IV then looks at international acquisitions, including inbound acquisitions (*i.e.*, acquisitions by foreign acquirors of U.S. targets) and outbound acquisitions (*i.e.*, acquisitions by U.S. acquirors of foreign targets) (Chapter 26). This international chapter looks at corporate, securities, tax, and antitrust issues that can arise in such transactions in the following foreign jurisdictions: The European Economic Community; the U.K.; Germany; and France. The final chapter considers acquisitions of banks and bank holding companies (Chapter 27). This chapter illustrates some of the unique issues that can arise in the heavily regulated banking industry.

How to Use the Book

At the University of Miami School of Law, I cover most of the material in the first three parts (Building Blocks, Consensual Transactions and Hostile Transactions) in a four semester hour course, and I cover Part IV (spinoffs, international acquisitions, and bank acquisitions) in a two semester hour seminar. It would be difficult to cover all of the materials in this book in one course, even a four semester hour course.

The book can be used flexibly in a variety of courses. For example, the book could be used in a two semester hour course focusing on friendly transactions by covering the Building Block chapters in Part I (with the exception of the chapters on valuation, antitrust, and pre-merger notification) and the Consensual Transactions chapters in Part II. A three semester hour course could cover these materials, plus the materials on Hostile Acquisitions in Part III., and a four semester hour course could cover, as I do, essentially all of Parts I, II and III.

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