Lecture 4 (Notes by Leora Schiff)
15.649 - The Law of Mergers and Acquisitions (Spring 2003) - Prof. John Akula

Types of Acquisitions

Governed by state law:

1. Delaware
   a. Flexible for corporate managers
   b. Body of precedent
2. California
   a. Other end of spectrum – heavy regulations

I. Statutory Merger/Consolidation

A. Stock Swap Statutory Merger
   1. B merges into A
   2. A and B merge into C – consolidation
   3. stock-for-stock merger
      a. shareholders of B get stock in A (or C)
      b. A or C absorbs assets and liabilities of B corp
      c. Tax free - Type A reorganization

B. Cash-out Statutory Merger
   1. shareholders of B receive cash, debentures or non-voting equity
   2. Taxable merger

C. Procedure for Statutory Merger
   a. BOD both A and B pass resolution approving Agreement of Merger
   b. A and B shareholder vote - majority of outstanding shares entitled to vote must ratify agreement
   c. Certificate of Merger filed with DE Secy of State to become effective on date specified
   d. On date, reps. of both corporations meet and close transaction

D. Three Exceptions to Voting Procedures
   1. small-scale merger exception
   2. parent-sub merger exception
   3. holding company exception

E. Conditions for Closing
   1. Material Adverse Condition clause – depending on terms, could choose not to close.

II. Asset Acquisition

A. Cash-for-Assets Acquisition

1. Taxable transaction
2. A can select assets and liabilities of B
3. A shareholders do not vote on asset acquisition
4. B shareholders are cashed out
5. A corp. gets new basis in B assets based on allocation of purchase price

B. Stock-for-Assets Acquisition

1. Tax free – Type C reorganization
2. A buys all B's assets and assumes all liabilities
3. Procedure
    a. B corp's BOD submits resolution to shareholders to sell substantially all corporate assets
    b. Majority of B's outstanding shares entitled to vote must ratify
    c. A corp shareholders not entitled to vote

III. Stock Acquisition

A. Cash-for Stock Acquisition

1. Result: A corp is parent, B corp is subsidiary
    a. Creditors of B can make no claim on A corp assets
2. B corp shareholders
    a. If all have tendered and exchanged shares for cash – wholly-owned subsidiary
    b. B shareholders not tendering keep B shares – minority; partially owned subsidiary
3. Taxable transaction

B. Stock-for-Stock Acquisition

1. Result: A corp is parent, B corp is subsidiary
2. Tax free – Type B reorganization
3. Neither shareholders of A or B can vote on acquisition– B shareholders choose to tender or not
4. B corp shareholder protections
    a. Appraisal rights
    b. Anti-takeover statutes – if target board disapproves acquisition, shareholders can vote whether A corp can execute second-stage, cash-out statutory merger to squeeze out minority; known as freeze-out

IV. Triangular Statutory Mergers

A. Two-Stage Stock Acquisitions

1. Stage 1: stock acquisition
2. Stage 2: back-end merger
    a. Purchasing corporation drops down a subsidiary, NewCo
    b. Merges subsidiary with partially-owned target
        i. B subsidiary can't vote on merger
        ii. B is merged into Newco
        iii. Remaining B corp shareholders cashed out – cash or A corp debentures
        iv. Result: A is parent of subsidiary, NewCo which holds assets & liabilities of B
3. Purpose
    a. Speed – can gain control of target faster since can close first stage faster than statutory merger or asset sale

B. Single-Firm Recapitalization

1. Step 1: A corp drops down subsidiary, NewCo
2. Stage 2: A corp merges itself into the subsidiary, NewCo
    a. All stock in A corporation is cancelled
    b. Majority shareholders in A corp receive stock in NewCo
    c. Minority shareholders cashed out – get rid of annoying minority

C. Triangular Acquisitions

1. Process
    a. Purchasing firm drops down wholly-owned sub, NewCo
    b. Selling firm merges with subsidiary
    c. Shareholders of parent to do not vote on acquisition
    d. Subsidiary shareholder = parent; BOD of parent votes the stock in favor of merger by board resolution
    e. Purpose
        i. Limit voting rights of purchasing shareholders (A corp)
        ii. Isolate liabilities of B corp in a subsidiary
        iii. For these reasons, very popular

2. Forward Triangular Merger
    a. Target merges into NewCo

3. Reverse Triangular Merger
    a. NewCo merges into target
    b. Purpose
        i. Retain Target's contracts

4. Triangular asset acquisition
    a. NewCo purchases B's assets

V. Leveraged Buy-Out

A. Process

1. Group of investors led by an LBO fund (private LP) creates an acquisition vehicle, Temporary Co., and funds entity with some cash
2. TempCo purchases 50% of outstanding shares in Target, a public company
3. TempCo merges into target
   a. Remaining outstanding shares of Target exchanged for debt or non-voting preferred securities
   b. TempCo shareholders keep shares of Target
4. Surviving Target assumes debt of TempCo
5. Result:
   a. Target public company becomes private company
   b. Target has significantly increased debt:equity ratio
   c. Target must pay back loans by selling bonds, reducing expenses and selling assets