Chapter 1

Introduction

§ 1:1 Scope of Book
§ 1:2 Scope of Chapter
§ 1:3 Introduction to Consensual Transactions
§ 1:3.1 The Starting Point: Valuation and Due Diligence
§ 1:3.2 Structuring the Transaction: Tax and Corporate Law Considerations
[A] In General
[B] Stock Purchase Structure
[C] Asset Purchase Structure
[D] Direct Merger Structure
[E] Reverse Subsidiary Merger Structure
[F] Forward Subsidiary Merger Structure
[G] Compulsory Share Exchange Structure
[H] Short-Form Merger Structure
§ 1:3.3 Drafting the Acquisition Agreement
§ 1:3.4 Federal Securities Laws Considerations
§ 1:3.5 Antitrust, Pre-Merger Notification, and Regulatory Considerations
§ 1:4 Introduction to Tender Offers and Related Transactions
§ 1:5 Do the Shareholders of the Target and Acquirer Benefit in Mergers and Acquisitions?
§ 1:5.1 Introduction
§ 1:5.2 Recent Evidence that Acquirer Shareholders Are Benefiting in More Mergers
§ 1:6 Strategy for Approaching Mergers
§ 1:7 The Current M&A Scene
§ 1:7.1 Introduction
§ 1:7.2 Strategic, Private Equity, and SPAC Deals
§ 1:7.3 Past Trends in U.S. M&A Activity
§ 1:7.4 Introduction to Recent Data on the M&A Marketplace
§ 1:7.5 Recent Trends in U.S. M&A Activity
§ 1:7.6 Recent Trends in U.S. and Worldwide M&A Activity
§ 1:7.7 Recent U.S. M&A Volume Related to Aggregate GDP

§ 1:7.8 Recent U.S. M&A Volume As a Percentage of Aggregate GDP
§ 1:7.9 Recent U.S. M&A Volume Related to Investment Component of GDP
§ 1:7.10 Recent U.S. M&A Volume Related to the S&P 500
§ 1:7.11 Recent U.S. M&A Activity by Type of Transaction
§ 1:7.12 Recent P:E Ratios and Premiums Paid in U.S. Public Deals
§ 1:7.13 Recent U.S. Payment Trends: Cash, Stock, Mixed, and Other
§ 1:7.14 Recent Data on Acquisitions of Publicly Traded Companies
§ 1:7.15 Recent Data on Acquisitions of Privately Owned Companies
§ 1:7.16 Recent Private Equity Capital Raising and Equity Contributions
§ 1:7.17 Recent Data on U.S. Deal Size
§ 1:7.18 Recent Data on U.S. Regional Buyer Activity
§ 1:7.19 Recent Data on U.S. Regional Seller Activity
§ 1:7.20 Recent Data on the Percentage of S&P 500 Companies with a Shareholder Rights Plan, Poison Pill
§ 1:7.21 Recent Data on the Percentage of S&P 500 Companies with Various Types of Defensive Measures
§ 1:7.22 Recent Data on U.S. Tender Offers, Contested and Uncontested
§ 1:7.23 Recent Data on the Rise of Two-Step Transactions and the Top-Up Option
§ 1:7.24 Recent Data on U.S. Termination Fees
§ 1:7.25 Recent Data on Matching Rights in Negotiated Deals
§ 1:7.26 Recent Data on Go-Shops in Negotiated Deals
§ 1:7.27 Recent Information on Bankruptcies
§ 1:7.28 Recent ABA Deal Point Studies
§ 1:7.29 Recent Information on the Top Ten M&A Investment Banks and Law Firms Ranked by U.S. Deal Size
§ 1:7.30 Proxy Contest for the Five Year Period, 2009 to 2013
§ 1:7.31 Recent Data on Cross-Border M&A Activity
§ 1:7.32 Recent Data on the Top Ten Foreign Buyer Countries
§ 1:7.33 Recent Data on the Top Ten Foreign Seller Countries
§ 1:7.34 The Trapped Foreign Income Problem and M&A
§ 1:7.35 The Inversion Problem, Pfizer and Beyond
§ 1:7.36 Preliminary Report on M&A Activity in 2014
§ 1:8 Introduction to Corporate Governance Issues Generally
§ 1:8.1 Background
§ 1:8.2 Overview of Corporate Governance at the State Level
§ 1:8.3 Overview of Corporate Governance at the Federal Level
§ 1:8.4 Overview of Corporate Governance Provisions in SOX
§ 1:8.5 Overview of Corporate Governance Provisions in Dodd-Frank
§ 1:9 Guide to References

§ 1:1 Scope of Book

This book is a guide to the following aspects of domestic and cross-border mergers, acquisitions, and tender offers (M&A): corporate,

securities, federal income tax, antitrust, pre-merger notification, accounting, and valuation.[1] The book focuses on both private company and public company acquisitions and both negotiated and hostile transactions in which an acquiring corporation (acquirer) acquires by merger or otherwise the stock or assets of a target corporation (target). The book takes a practical approach to these topics, and many of the chapters have appendices containing deal documents illustrating the practical application of the particular topic. Because of the dynamic nature of M&A, an annual supplement will be published.

After this introductory chapter, the book is divided into eight parts:

- Part I, Contract Law and Related Considerations in M&A, Including Drafting of Acquisition Agreements;
- Part II, Corporate Law Considerations in M&A;
- Part III, Federal Securities Law Considerations in M&A;
- Part IV, Federal Income Tax, Accounting, and Valuation Considerations in M&A;
- Part V, U.S. Substantive Antitrust and Pre-Merger Notification Considerations in M&A;
- Part VI, Domestic M&A Transactions Presenting Unique Issues;
- Part VII, Cross-Border Considerations in M&A; and
- Part VIII, Special Topics.

Part I, *Contract Law and Related Considerations in M&A, Including Drafting of Acquisition Agreements,* contains chapters 2 and 3. Every negotiated M&A transaction has an acquisition agreement, and for this reason, chapter 2 focuses on the drafting of the following acquisition agreements: stock purchase agreements, asset acquisition agreements, and merger agreements. The chapter refers extensively to numerous real-world acquisition agreements included in the appendices to the chapter. These agreements are from a range of deals, including stock purchase agreements for a closely held corporation and for a subsidiary; asset acquisition agreements for a closely held corporation and a division; and merger agreements for acquisitions of a publicly held target for cash and for stock. Chapter 3 addresses confidentiality agreements, due diligence and letters of intent. These three topics are addressed together because they usually are linked in negotiated transactions; the due diligence examination of confidential information

---

1. The author thanks Nathaniel L. Doliner of Carlton Fields, PA for his helpful comments on a draft of this chapter. Of course, the author is responsible for any errors.

does not begin until a confidentiality agreement is in place, and a letter of intent may be used to set out a tentative deal pending completion of the due diligence process. Chapter 3 analyzes a real-world confidentiality agreement and letter of intent, which are included in the appendices. Also, the appendices contain a due diligence checklist.

Part II, *Corporate Law Considerations in M&A*, which contains chapters 4 and 5, discusses state corporate law and related considerations in M&A. Most publicly held corporations are incorporated in Delaware, and for that reason, this part focuses principally on Delaware corporate law. Since the Model Business Corporation Act of 2005 (MBCA) reflects the latest thinking of the American Bar Association on corporate law issues and is followed by many states, this part also addresses the approach of the MBCA to these issues. In addition, this part considers the proposals adopted by the American Law Institute in its *Principles of Corporate Governance.*

Chapter 4 focuses on (1) the structuring of mergers, sales of substantially all of a target's assets, and compulsory share exchanges, and (2) the shareholder voting and dissenting rules for such transactions. These are transactions that can only be consummated after a vote of the target's shareholders and possibly the acquirer's shareholders.

In a compulsory share exchange, an acquirer *acquires* by operation of law all of the shares of a target. Although Delaware law does not contain a compulsory share exchange provision, the MBCA contains such a provision. In illustrating (1) the structure of mergers and sales of substantially all of a target's assets, and (2) the shareholder voting and dissenting rights in such transactions, the chapter refers to many of the acquisition agreements contained in the appendices to chapter 2, which deals with the drafting of acquisition agreements.

Chapter 5 deals with the fiduciary duties of directors in all types of M&A transactions, including negotiated arm's-length mergers, hostile tender offers, and freeze-out mergers. This fiduciary law is most highly developed in the Delaware courts, and the chapter focuses on, inter alia, the Delaware approach to the duty of loyalty, the duty of care, the business judgment rule, the enhanced business judgment rule of *Unocal*, the *Revlon* duty, the compelling justification standard of *Blasius*, and the entire fairness standard. This chapter also discusses poison pills, the principal defensive barrier against a hostile tender offer, and the fiduciary principles in Delaware and certain other states governing the utilization by a target's board of a pill and of deal protection devices in negotiated transactions.

Part III, *Federal Securities Law Considerations in M&A*, contains chapters 6, 7, and 8. Chapter 6 provides an introduction to the Securities Act of 1933 (the '33 Act) and the Securities Exchange Act of 1934 (the '34 Act). This chapter addresses the preparation of registration statements for (1) an initial public offering (IPO) on

Form S-1, and (2) a follow-on offering on Form S-3 by a seasoned issuer, including a "well-known seasoned issuer." An IPO may be an alternative to an M&A transaction and consequently, it is important for the deal lawyer to have a basic understanding of the issues that can arise in an IPO. In this connection, an appendix to this chapter contains an annotated IPO on Form S-1, which is analyzed in the chapter. The chapter covers the reporting obligations of publicly held firms, including the impact of the Sarbanes-Oxley Act and the requirement that such firms file periodic reports on Form 10-K (annual report), Form 10-Q (quarterly report), and Form 8-K (interim report of major events). This chapter also analyzes the impact in the acquisition of a closely held target of the following exemptions: (1) the statutory private offering exemption, (2) the Regulation D safe harbor exemption, (3) the section 4(1½) exemption, and (4) the exemption for re-sales under Rule 144. These principles are illustrated by referring to a private offering memorandum that is an appendix to the chapter. Also, this chapter discusses Rule 144A, which permits free trading of certain unregistered securities among "qualified institutional buyers" (QIBs).

Chapter 7 addresses the impact of the '33 and '34 Acts in negotiated acquisitions of publicly held companies, including the operation of Rule 145; registrations on Form S-4 of mergers in which the considerations are securities; preparation of proxy statements for cash mergers; and the role of Regulation M-A. The appendices to this chapter contain SEC disclosure documents for several recent public company negotiated acquisitions.

Chapter 8 deals with the treatment under the federal securities laws, principally the Williams Act amendments to the '34 Act, of tender offers, open market purchases, and going private transactions. Thus, this chapter examines (1) the early warning system applicable under section 13(d) of the '34 Act when an acquirer acquires more than 5% of the stock of a publicly held company, (2) the third-party tender offer rules of sections 14(d) and (e) of the '34 Act, and (3) the going private and issuer tender offer rules under section 13(e) of the '34 Act. This chapter also looks at state regulation of tender offers. Tender offer defensive tactics, such as the poison pill, and the fiduciary duties applicable to such tactics are examined in chapter 5. The appendices to the chapter contain, inter alia, tender offer documents relating to Oracle's tender offer for PeopleSoft and the Rule 13e-3 disclosure document for the Getty Images going private transaction.

Part IV, *Federal Income Tax, Accounting, and Valuation Considerations in M&A*, contains chapters 9, 10, and 11. Chapter 9 discusses federal income tax considerations in structuring both taxable and tax-free acquisitions of domestic targets by domestic acquirers. Chapter 9, therefore, examines, inter alia, the reorganization provisions of the Internal Revenue Code. The chapter illustrates the various types

of transactions by referring to acquisition agreements contained in chapter 2. While chapter 9 briefly addresses the federal income tax consequences of a spin-off (that is, the distribution by a parent corporation of the stock of a subsidiary to the parent's shareholders), chapter 15 addresses in detail the tax and non-tax issues arising in a spin-off. Chapter 10 covers the financial and SEC accounting considerations in M&A. The chapter discusses the new "acquisition method" for accounting for an acquisition, the rules regarding the treatment of goodwill, including the goodwill impairment rules, and the SEC's rules regarding the reporting of the accounting results of various types of acquisition transactions. The appendices contain illustrations of the required SEC reports.

Chapter 11 addresses valuation techniques employed by investment banks and others in M&A transactions. The chapter first focuses on the discounted cash flow method with the use of the Capital Asset Pricing Model (CAPM) and the Weighted Average Cost of Capital (WACC) for determining the discount rate. The chapter then discusses the comparable companies and comparable transactions techniques. The chapter also discusses the rules of the Financial Industry Regulatory Authority (FINRA) dealing with the issuance by investment bankers of fairness opinions, and the structuring of engagement letters with investment bankers. The appendices to chapter 11 contain several illustrations of both valuation techniques and the discussions of the valuations in SEC disclosure documents. The appendices also contain sample investment banker engagement letters.

Part V, *U.S. Substantive Antitrust and Pre-Merger Notification Considerations in M&A*, contains chapters 12 and 13. Chapter 12 discusses U.S. substantive antitrust analysis of M&A under section 7 of the Clayton Act, with the principal focus on the Horizontal Merger Guidelines of the Federal Trade Commission (FTC) and the Department of Justice (DOJ). Mergers and other acquisitions above certain thresholds are subject to pre-merger notification under the Hart-Scott-Rodino (HSR) Act, and chapter 13 discusses these rules. An appendix to chapter 13 contains the antitrust-related provisions of the Whirlpool–Maytag merger agreement. That transaction had significant antitrust risk and provided for the payment of a "reverse break-up fee" by the acquirer if the antitrust authorities blocked the deal.

Part VI, *Domestic M&A Transactions Presenting Unique Issues*, contains chapters 14 through 18. Chapter 14 addresses leveraged buyouts (LBOs), which are transactions in which a target is acquired in a transaction in which the acquirer raises a large part of the consideration by issuing debt. Chapter 15 discusses corporate, securities, tax, and fraudulent conveyance issues relating to transactions in which a parent corporation distributes to its shareholders the stock of a subsidiary in a spin-off transaction. The chapter also addresses the use of a spin-off in connection with an acquisitive reorganization,

which was employed by Comcast in its acquisition of AT&T Broadband. Chapter 16 addresses fundamental issues in acquisitions of bankrupt companies, with a focus on American Airlines's acquisition of bankrupt TWA and Barclays's acquisition of the investment banking assets of bankrupt Lehman Brothers.

Chapter 17 covers regulatory issues that can arise in acquisitions of financial institutions, with an emphasis on the federal banking laws administered by the Federal Reserve Board (FRB) in acquisitions of financial holding companies. Chapter 18 looks at the regulatory issues arising under (1) the federal communications law administered by the Federal Communications Commission (FCC) in acquisitions in the telecommunications and related industries; and (2) the federal energy laws administered by the Federal Energy Regulatory Commission (FERC) in acquisitions of electric utilities. Chapters 14 through 18 contain appendices illustrating the various transactions.

Part VII, *Cross-Border Considerations in M&A*, contains chapters 19 through 22. Chapter 19 discusses U.S. corporate, securities, antitrust, and Exon-Florio (that is, national security) issues in inbound cross-border M&A. These are transactions in which a foreign acquirer acquires a U.S. target, such as the 2008 acquisition by InBev, a Belgian company, of Anheuser-Busch. The appendices to the chapter contain deal documents from the InBev transaction and also from the acquisition by the U.K.'s Vodafone of AirTouch. Issues regarding the Foreign Corrupt Practices Act, which can arise when a U.S. target has overseas operations, are addressed briefly in chapter 2, which deals with drafting of acquisition agreements.

Chapter 20 addresses U.S. and foreign corporate, securities, antitrust, and investment restriction issues in outbound cross-border M&A. These are transactions in which a U.S. acquirer acquires a foreign target, such as the 2004 acquisition by GE of the U.K.'s Amersham pursuant to a scheme of arrangement under U.K. law. Rather than attempting to focus on foreign laws from several jurisdictions, this chapter focuses principally on (1) the relevant rules promulgated by the European Union, including the EU's Takeover Directive and Merger Control Regulation; and (2) the U.K.'s takeover and scheme of arrangement rules. The appendices to this chapter include the deal documents from the Amersham transaction and from the NASDAQ Stock Market's unsuccessful tender offer for the stock of the London Stock Exchange.

Because tax considerations are such a large part of cross-border transactions, chapter 21 focuses on the federal income tax treatment of inbound and outbound M&A transactions structured as taxable acquisitions, and chapter 22 addresses the federal income tax treatment of tax-free inbound, outbound, and completely foreign acquisitions structured as tax-free reorganizations. The appendices to chapter 22

contain excerpts from the deal documents in the following transactions that were structured as tax-free reorganizations: (1) British Telecom's failed attempt to acquire MCI, and (2) Daimler-Benz's acquisition of Chrysler.

Part VIII, *Special Topics*, contains six chapters. Chapter 23 introduces some of the issues that can arise in determining the taxation of M&A transactions under state income and sales taxation laws. Chapter 24 examines issues involved in organizing a joint venture, including tax, antitrust, partnership, and limited liability company aspects of such transactions. A joint venture can be used as an alternative to an M&A transaction. Chapter 25 presents a checklist guide to issues that can arise in the various prototypical transactions covered in this book. The checklist refers to the chapters that cover the particular issue. Chapter 26 addresses ethical issues in M&A and related transactions. In view of the enactment of new health care legislation in 2010 and the growing importance of M&A in the health care sector, chapter 27 discusses health care M&A.

Finally, as a result of the increasing importance of shareholder activism, particularly by activist hedge funds, chapter 28 looks at various aspects of this topic, including securities and pre-merger notification. Activism is also addressed in various other chapters of the book in the context of the topic covered. In addition, chapter 28 deals with a related topic: merger arbitrage, which is sometimes referred to as risk arbitrage.

§ 1:2 Scope of Chapter

This chapter introduces some of the underlying concepts addressed in this book. Section 1:3 discusses consensual transactions in which a willing target corporation is acquired by an acquirer in an arm's-length transaction, and section 1:4 introduces tender offers and open market purchases. Section 1:5 looks at the evidence on whether the shareholders of the target and acquirer recognize economic gains in mergers and acquisitions. Section 1:6 takes a quick look at strategic reasons for engaging in mergers and acquisitions, and section 1:7 provides an introduction to the state of the M&A marketplace. Finally, section 1:8 provides a guide to the vast literature on mergers and acquisitions.

§ 1:3 Introduction to Consensual Transactions

§ 1:3.1 The Starting Point: Valuation and Due Diligence

The starting point for any consensual M&A transaction is the determination by the acquirer of the amount it would be willing to pay for the target and the determination by the target's directors or

shareholders of the amount they would be willing to accept from the acquirer. This requires that the target be properly valued, and chapter 11 discusses the principles underlying modern valuation techniques. Before a target can be properly valued, the acquirer must have access to confidential information on the target so that the acquirer can complete its due diligence, and chapter 3 provides a guide to drafting a confidentiality agreement and the conduct of due diligence. If the acquirer will be paying cash, the target will generally not conduct extensive due diligence regarding the acquirer. However, if the acquirer will be issuing stock the target's shareholders will be making an investment in the acquirer, and the target will generally conduct extensive due diligence on the acquirer, which will require access to confidential information pursuant to a confidentiality agreement. In some cases, the parties may come to a basic agreement before they have completed the due diligence process, and they may enter into a letter of intent or similar document, also discussed in chapter 3.

§ 1:3.2 Structuring the Transaction: Tax and Corporate Law Considerations

[A] In General

Once the parties have come to an agreement on price and the other basic terms, the transaction will have to be structured. This will principally present corporate and tax law issues addressed in chapter 4 (transaction structures and shareholder voting and dissenting rules), chapter 5 (directors' fiduciary duties), chapter 9 (domestic tax), and chapters 21 and 22 (cross-border tax). There is a potential "chicken and egg" problem in creating the structure, because as explained in chapter 9, in a taxable acquisition an acquirer should generally pay less in a stock acquisition of a stand-alone (that is, non-subsidiary) target than in an asset acquisition. Thus, if an acquirer has valued the target on the assumption that the acquirer will have a cost basis for the target's assets, but the transaction is structured as a stock acquisition without a cost basis for those assets, the acquirer may be overpaying. If the acquirer values the target before the structure of the transaction is set, the acquirer should offer one price for an acquisition of the target's assets and a lower price for the target's stock. Chapter 9 discusses how an acquirer might go about determining the lower price.

In general, the structure of the transaction will not be sensitive to the financial accounting treatment of the transaction, because as discussed in chapter 10, without respect to the form of the acquisition, the transaction will be accounted for as if the acquirer purchased the target's assets. This purchase accounting rule will create goodwill on the acquirer's balance sheet when the purchase price exceeds the book value of the target's assets.

The following sections discuss the most common structures used in consensual, that is, non-hostile, deals: the stock purchase, the asset purchase, the direct merger, the reverse subsidiary merger, the forward subsidiary merger, the compulsory share exchange, and the short-form merger. The diagrams employ the following shorthand definitions of the various parties to the transactions:

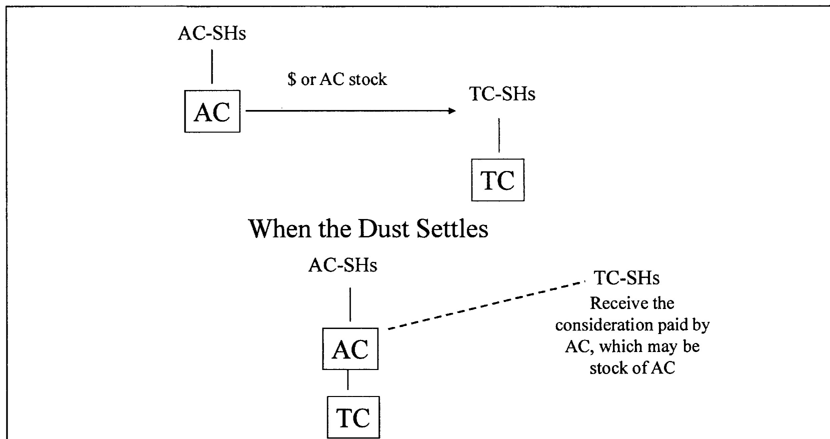
- Acquiring Corporation = AC
- Wholly Owned Subsidiary of AC = AC-S
- Target Corporation = TC
- Shareholders of AC = AC-SHs
- Shareholders of TC = TC-SHs

[B] Stock Purchase Structure

In the case of an acquisition of a stand-alone closely held corporation, the principal acquisition structure is a stock purchase pursuant to a stock purchase agreement such as Appendix 2B, Fortress–SMLB Stock Purchase Agreement. This structure, which can also be utilized in the acquisition of a subsidiary, is illustrated in Diagram 1-1.

Diagram 1-1

Stock Purchase Structure

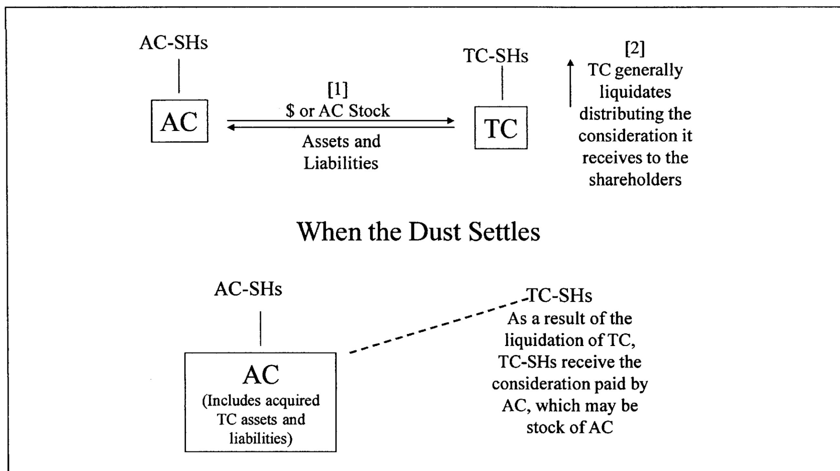


[C] Asset Purchase Structure

In some cases the acquisition of a closely held corporation or a subsidiary will be structured as an asset acquisition pursuant to an asset acquisition agreement such as Appendix 2A, Taleo–JobFlash Asset Acquisition Agreement. This structure is illustrated in Diagram 1-2.

Diagram 1-2

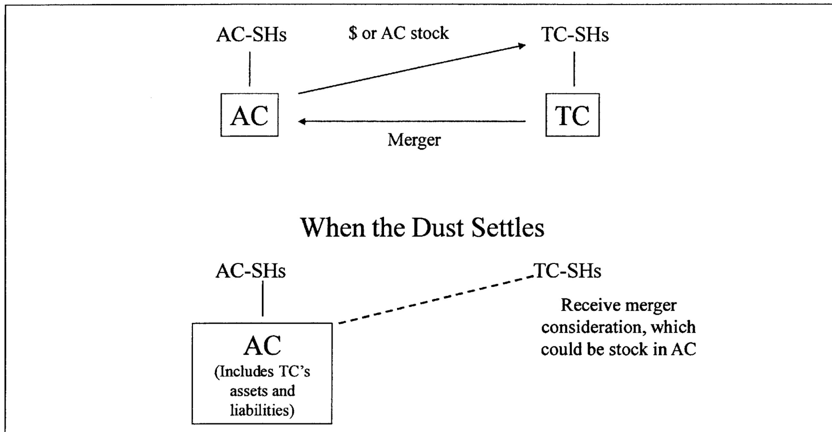
Asset Purchase Structure



[D] Direct Merger Structure

In the direct merger structure, the target merges pursuant to state law directly into the acquirer with the target's shareholders receiving the consideration. This type of transaction can be used in the acquisition of a closely held or publicly held target. For an illustration of a merger of a publicly held target into a publicly held acquirer see Appendix 17A, J.P. Morgan Chase–Bank One Merger of Financial Holding Companies. This structure is illustrated in Diagram 1-3.

Diagram 1-3
Direct Merger Structure

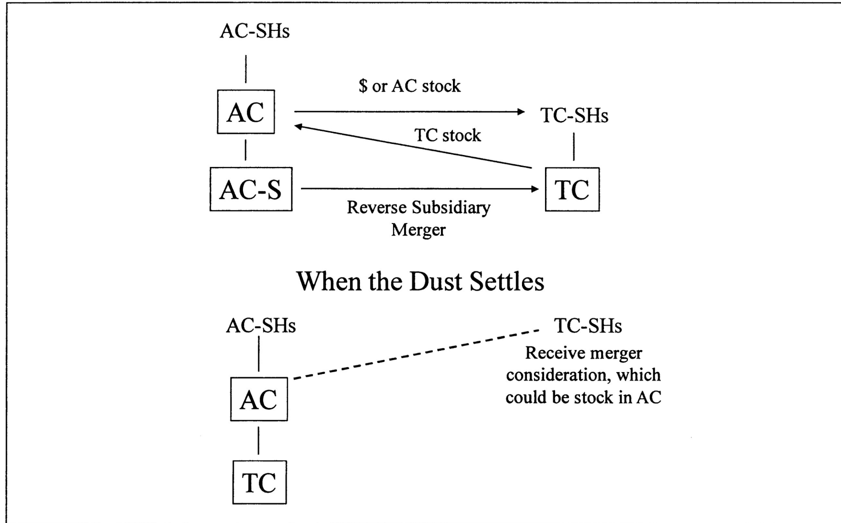


[E] Reverse Subsidiary Merger Structure

In the case of the acquisition of a stand-alone publicly held corporation, the principal acquisition structure is a reverse subsidiary merger. In this transaction, the acquirer forms a subsidiary that merges into the target; the target's shareholders receive the merger consideration; and the acquirer ends up owning all of the target's stock. For reasons discussed in chapter 4, Structuring Mergers, Asset Acquisitions, and Compulsory Share Exchanges, and chapter 9, Federal Income Tax Considerations in Taxable and Tax-Free Domestic M&A, the reverse subsidiary merger is generally employed in a taxable acquisition where the consideration is cash, as with Appendix 2D, Toys "R" Us Reverse Subsidiary Cash Merger Agreement, and also in a tax-free reorganization where the consideration is stock, as with Appendix 2C, Sirius–XM Reverse Subsidiary Stock Merger Agreement. This structure can be employed in the acquisition of closely held and publicly held targets, and Diagram 1-4 illustrates the transaction in the acquisition of a publicly held target.

Diagram 1-4

Reverse Subsidiary Merger Structure

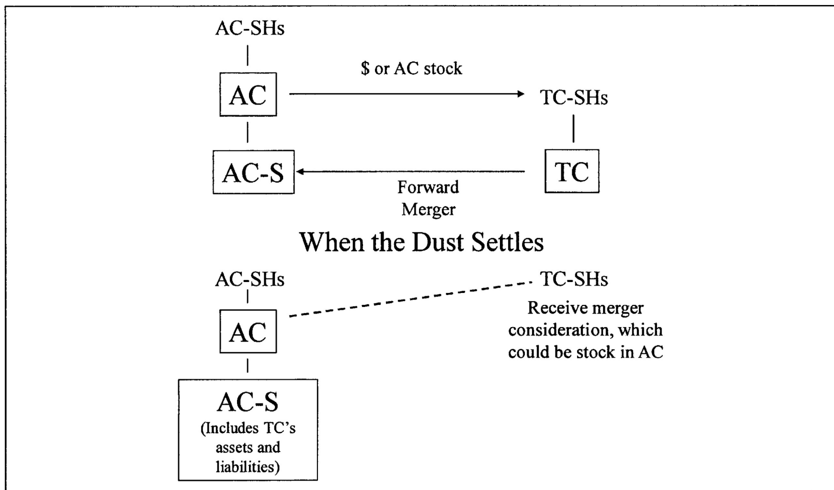


[F] Forward Subsidiary Merger Structure

In some subsidiary mergers, the target merges into the subsidiary of the acquiring corporation, with the target's shareholders receiving the merger consideration. This type of transaction is called a forward subsidiary or triangular merger. As indicated in chapter 9, the tax consequences of engaging in a forward subsidiary merger can be dramatically different from the tax consequences of engaging in a reverse subsidiary merger. This type of transaction can be utilized in acquisitions of both closely held and publicly held targets, and Diagram 1-5 illustrates the transaction in the acquisition of a publicly held target.

Diagram 1-5

Forward Subsidiary Merger Structure

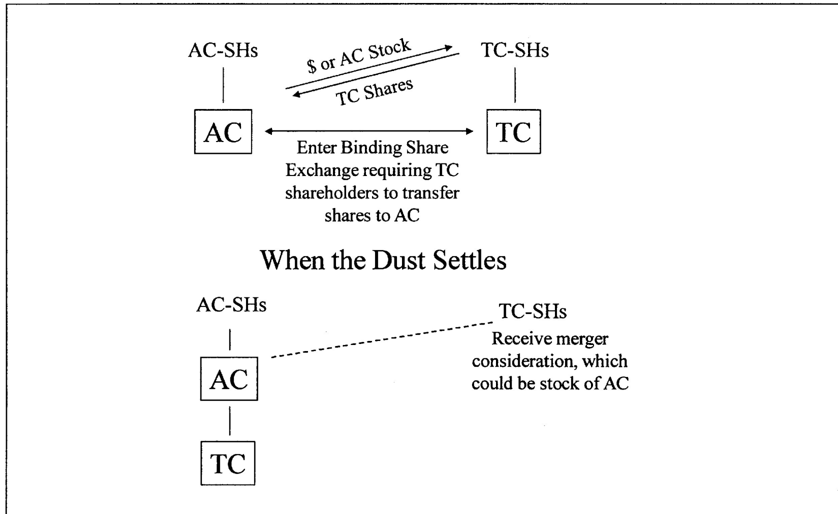


[G] Compulsory Share Exchange Structure

As discussed in chapter 4, the Model Business Corporation Act and some state laws permit the acquisition of a target's shares in a compulsory share exchange. In this transaction, pursuant to operation of law, the target's shareholders are required to transfer their shares directly to the acquirer in exchange for the consideration required to be paid in the transaction. Although Delaware law does not have a compulsory share exchange provision, the end result of a reverse subsidiary merger, which is permitted in all states, is generally the same as the end result with a compulsory share exchange, that is, the acquirer ends up owning all of the shares of the target. Diagram 1-6 illustrates an acquisition of a publicly held target in a compulsory share exchange.

Diagram 1-6

Compulsory Share Exchange Structure

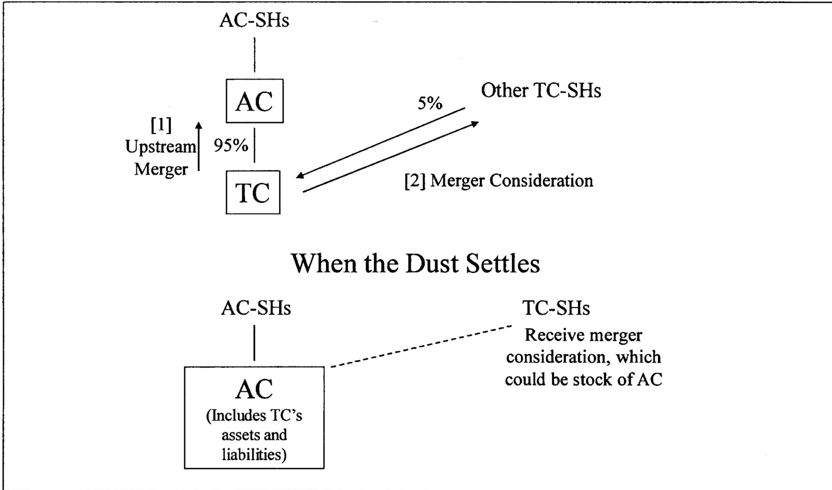


[H] Short-Form Merger Structure

Where a parent corporation owns 90% or more of the stock of a subsidiary, under the laws of most if not all states, the parent can acquire the assets and liabilities of the subsidiary without a vote of the subsidiary's shareholders. This type of transaction is called an upstream short-form merger and is explored in chapter 4. Also, the parent can merge downstream into the subsidiary, and some states permit a short-form merger to be used in a merger of sister subsidiaries. Also, in some states the ownership level for a short-form merger is less than 90%. A short-form merger may be utilized (1) to acquire a long-held subsidiary, and (2) as the follow-up step after a tender offer. Diagram 1.7 illustrates an upstream short-form merger.

Diagram 1-7

Short-Form Merger Structure



§ 1:3.3 *Drafting the Acquisition Agreement*

As discussed in chapter 2, the provisions of the acquisition agreement generally will follow the same basic structure without regard to the type of agreement. The agreement will start with the parties and the "whereas" clauses or "recitals," which set out the basic framework of the deal. The agreement will then address the heart of the transaction, specifying (1) the assets or stock to be acquired or the form of merger, (2) the consideration to be paid, and (3) the mechanics for closing the transaction. The agreement next contains representations and warranties, which are statements of fact. The target or its shareholders generally will make extensive representations and warranties, as will the acquirer if the consideration is stock. However, if the consideration is cash, the acquirer's representations and warranties usually are quite limited. The agreement then generally sets out covenants that deal with matters the parties "will do" (that is, affirmative covenants) and "will not do" (that is, negative covenants) between the signing and the closing. The covenants generally are followed by the conditions to closing, which are followed by the provisions governing the termination of the agreement and miscellaneous provisions. If the transaction involves the acquisition of a closely held corporation, the selling shareholders generally will provide the acquirer with indemnification against certain losses,

including losses resulting from materially inaccurate representations and warranties, which generally will survive the closing. On the other hand, in acquisitions of publicly held targets, the representations and warranties generally do not survive the closing and there is no indemnification.

§ 1:3.4 Federal Securities Laws Considerations

The treatment under the federal securities laws of the transaction is generally not sensitive to the structure of the transaction. As explained in chapters 6 and 7, without respect to the structure of the transaction, if the acquirer does not issue securities in the transaction, the acquirer will not have to register the transaction under the '33 Act. On the other hand, without respect to the structure of the transaction, if the acquirer issues securities, such as its stock, in the transaction, (1) in the case of an acquisition of a publicly held target, the acquirer will have to register such stock on Form S-4, and (2) in the case of an acquisition of a closely held target, the acquirer will have to register the stock or establish an exemption from registration, such as an exemption under Regulation D. If the stock is issued pursuant to an exemption from registration, the target's shareholders will have limits on their ability to resell the securities; such resales are generally made pursuant to Rule 144.

In the acquisition of a publicly held target, the target's shareholders will always have the right to vote on the transaction under the applicable corporate law (see chapter 4), and the acquirer's shareholders may have the right to vote if, inter alia, the acquirer issues more than 20% of its stock in the transaction (see chapter 4). As discussed in chapter 7, in the acquisition of a public target (1) a proxy statement under section 14(a) of the '34 Act will have to be prepared for the target's shareholders and for the acquirer's shareholders if they have the right to vote, and (2) a registration statement will have to be prepared by the acquirer if it issues securities in the transaction. The registration statement and the proxy statement or statements can all be included in one disclosure document on Form S-4. If the consideration is cash, only a proxy statement for the target's shareholders is required.

§ 1:3.5 Antitrust, Pre-Merger Notification, and Regulatory Considerations

If the consideration paid is above certain dollar thresholds, the parties will be required to make a pre-merger notification filing with the applicable antitrust authorities, such as the FTC and DOJ in the United States (discussed in chapter 13), the Competition Commission

in the EU (discussed in chapter 20), or the antitrust (that is, "competition") authorities in other countries where the parties conduct business. In both the United States and the EU, pre-merger notification may be filed on the basis of a letter of intent or similar document. The advantage of filing on the basis of such a document is that the parties can start the waiting period during which the authorities scrutinize the transaction prior to the completion of the definitive acquisition agreement.

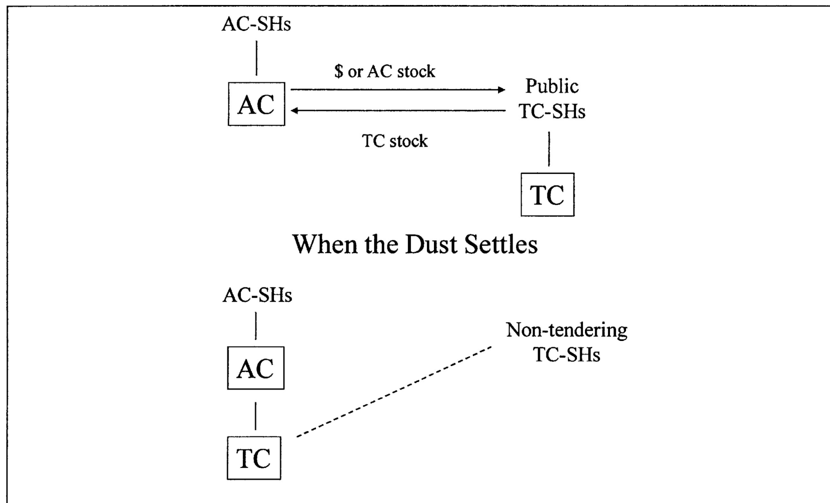
In addition to these basic considerations, unique corporate, securities, and tax issues can arise in leveraged buyouts, examined in chapter 14; spin-offs, examined in chapter 15; and acquisitions of bankrupt targets, examined in chapter 16. Also, mergers and acquisitions in regulated industries usually present unique regulatory issues; chapter 17 examines such issues with mergers in the financial services industry; chapter 18 addresses them with mergers in the telecom and utility industries; and chapter 27 considers regulatory issues arising in various M&A transactions in the health care industry.

Antitrust and regulatory issues generally will be addressed in the representations, covenants, and conditions provisions of the acquisition agreement (see chapter 2). The representations and warranties section will identify the antitrust and regulatory approvals required; the covenants section will address how the parties will deal with the antitrust and regulatory issues between signing and closing; and the conditions section will make receipt of the antitrust and regulatory approvals conditions to closing.

§ 1:4 Introduction to Tender Offers and Related Transactions

In a third-party tender offer an acquirer pursuant to an "offer to purchase" makes an offer directly to the shareholders of a publicly held target to purchase their shares for cash, stock, or any other type of consideration. This type of transaction is illustrated in Diagram 1-8.

Diagram 1-8
Tender Offer Structure



As discussed in chapter 8, tender offers for, and open market purchases of, the securities of publicly held targets are subject to regulation under the Williams Act provisions of the '34 Act, that is, principally sections 13(d) and (e), sections 14(d) and (e), and the regulations thereunder. Also, many states have laws, sometimes referred to as "Baby Williams Acts," regulating these transactions.

Section 13(d) sets out an early warning system to alert the target and the market whenever an acquirer or other person acquires more than 5% of the target's securities. Under section 13(d), the acquirer is required to make a public filing regarding its ownership interest in the target within ten days of crossing the 5% threshold. Further, as discussed in both chapters 5 and 8, the flip-in provisions of a firm's poison pill will prevent an acquirer from acquiring more than a specified percentage of the target's shares. In addition, the pre-merger notification rules will prevent an acquirer from acquiring more than a specified amount of a target's shares (approximately $63 million in 2010) prior to filing with the antitrust authorities and having the transaction cleared. Depending on the size of the target, the pre-merger filing may be required before the acquirer crosses the 5% threshold in section 13(d).

The acquirer can offer either cash or securities, such as its stock, in a tender offer. Where the acquirer offers securities the transaction is referred to as an exchange offer, and the transaction is subject to regulation under the '33 Act as well as the '34 Act. Cash tender offers are not subject to regulation under the '33 Act; only the '34 Act applies.

Tender offers can be either hostile or consensual. Consensual tender offers are generally set out in a merger agreement that provides for a first-step tender offer, which is to be followed by a second-step long-form or short-form merger. These transactions are discussed in both chapter 2 and chapter 8 and can be made pursuant to the type of merger agreement set out in Appendix 2E, Koch–Georgia Pacific, Tender Offer/Merger Agreement with Top-Up Option. As explained in chapter 8, consensual tender offer–mergers can allow the acquirer to get a controlling interest in the target in a shorter period of time than with a one-step merger.

Both consensual and hostile tender offers are basically subject to the same rules set out in sections 14(d) and (e) and the regulations thereunder, including the following: (1) the tender offer must remain open for twenty business days, (2) there must be unlimited withdrawal rights, and (3) all shareholders must receive the highest price offered during the tender offer.

Tender offers are made pursuant to an "offer to purchase" like the document in Appendix 8D, Oracle's Offer to Purchase in Tender Offer for PeopleSoft. The acquirer generally publishes a summary advertisement in the financial press such as Appendix 8C, Oracle's Summary Advertisement for Tender Offer for PeopleSoft. The tender offer can commence upon the filing of a Schedule TO, such as Appendix 8B, Oracle's Schedule TO for Tender Offer for PeopleSoft. No pre-clearance of the tender offer is required, although if the SEC discovers material inaccuracies, the acquirer may be required to extend the tender offer. Within ten business days of the commencement of a tender offer the target's board must file Schedule 14D-9 and take a position on the tender offer or state that it cannot take a position. See Appendix 8E, PeopleSoft Schedule 14D-9.

Hostile tender offers will face defensive tactics employed by the target's directors, and these tactics are discussed in both chapters 5 (fiduciary duties) and 8 (tender offers). Also, the acquirer will have to give careful attention to any Baby Williams Act that may be applicable. The acquirer may have to conduct a proxy contest (see chapter 8) to remove the target's board and dismantle the defensive measures, such as a poison pill.

Most tender offers are followed by a second-step merger to eliminate the remaining public shareholders of the target. The acquirer generally does not want to own less than 100% of the stock of the

target because the presence of minority shareholders can lead to litigation brought by shareholders regarding transactions between the parent and the sub. Second-step freezeout mergers as well as freezeout mergers that are not preceded by a tender offer may be subject to the SEC's going private rules under Rule 13e-3 under the '34 Act (see chapter 8). These rules require the acquiring parent or controlling group to explain why the transaction is fair to the minority shareholders. Also, such transactions may be subject to scrutiny under the entire fairness standard of review in Delaware and other states (see chapter 5).

§ 1:5 Do the Shareholders of the Target and Acquirer Benefit in Mergers and Acquisitions?

§ 1:5.1 Introduction

There are numerous studies of the economic effects of mergers, acquisitions, and takeovers. One of the most comprehensive guides to this extensive literature is a 1992 article by Professor Roberta Romano of the Yale Law School entitled: *A Guide to Takeovers: Theory, Evidence, and Regulation.*[2] As indicated by the following excerpt from this article, target shareholders benefit in all forms of acquisitions:

> One important, and undisputed, datum about acquisitive transactions should be noted from the outset: acquisitions generate substantial gains to target company shareholders. All studies find that target firms experience statistically significant positive stock price responses to the announcement of takeover attempts or merger agreements. On average, there is a 20% increase over the pre-announcement market price for mergers and a 30% increase for tender offers in the period around the takeover announcement. Abnormal returns in going-private transactions (leveraged buyouts) are of similar magnitude, ranging across studies between 20% and 37%. Without question, the announcement of a bid is good news for target shareholders.[3]

In a chapter entitled "Does M&A Pay?" in his 2004 book, *Applied Mergers & Acquisitions*, Dean Bruner makes the same point:

> Target firm shareholders enjoy returns that are significantly and materially positive . . . despite variations of time period, type of deal (merger vs. tender offer), and observation period. In short, the M&A transaction delivers a premium to target firm shareholders.[4]

---

2. Romano, *Guide to Takeover Theory, infra* Table of References.
3. *Id.* at 122.
4. Bruner, APPLIED M&A, *infra* Table of References, at 36.

Professors Manns and Anderson[4.1] have examined whether the large returns realized by target shareholders are attributable to (1) the basic price terms of the deal, or (2) the fine points included in the formal acquisition agreement as a result of negotiating by the lawyers over the legal terms of the deal. Their examination focused on mergers from 2002 through 2011 in which the only consideration was cash. They summarize their findings as follows:

> Our analysis shows that there is no economically consequential market reaction to the disclosure of the details of the acquisition agreement. Markets appear to recognize that parties publicly committed to a merger have strong incentives to complete the deal regardless of what legal contingencies are triggered.[4.2]

As indicated from the following excerpt from the Romano article, the evidence on the benefit to the shareholders of acquirers is less certain:

> The data are more ambiguous, however, concerning acquiring firms' returns. Depending on the sample and time period, acquirers experience positive, negative, or zero abnormal returns on a bid's announcement and completion. From the acquirer's perspective, there are two classes of explanations or motivations for a takeover: value-maximizing and non-value-maximizing ones. Value-maximizing explanations view takeovers as undertaken in order to increase the equity share price of the acquiring firm. Non-value-maximizing explanations consider takeovers in diametrically opposite terms, as transactions that maximize managers' utility rather than shareholder wealth. These two explanations therefore predict a different stock price reaction, positive and negative, respectively.[5]

Professor Romano sets out several possible explanations of why the returns to the acquirers are ambiguous:

> There are, however, theoretically plausible reasons for not finding positive abnormal returns to bidders even when acquisitions are value-maximizing transactions. First, acquiring firms are typically much larger than target firms, making it more difficult to measure abnormal returns. Second, a bid may reveal information about the bidding firm unrelated to the particular acquisition, confounding the stock price effect. Third, if the takeover market is competitive,

---

4.1. Jeffrey Manns and Robert Anderson IV, *The Merger Agreement Myth*, http://ssrn.com/abstract=2108360.

4.2. *Id*. at Abstract.

5. Romano, *Guide to Takeover Theory, infra* Table of References, at 123.

> then bidders will earn only normal returns, as abnormal profits are competed away. Finally, for acquiring firms that have an active mergers and acquisitions program, the gain from a specific acquisition may have been anticipated in the bidder's stock price at the time the mergers and acquisitions program was announced.[6]

Dean Bruner comes to a similar conclusion in his evaluation of several studies of the returns to acquirers:

> A reasonable conclusion from these studies is that in the aggregate, abnormal (or market-adjusted) returns to buyer shareholders from M&A activity are essentially zero. Buyers basically break even (*i.e.*, acquisitions tend to offer zero net present values or equivalently, investors earn their required returns).[7]

In his book, *The Synergy Trap: How Companies Lose in the Acquisition Game*, Professor Mark L. Sirower, a professor of business strategy and competitive analysis at the NYU Business School, emphasizes the significant challenges facing acquirers in mergers and acquisitions:

> Few, if any, corporate resource decisions can change the value of a company as quickly or dramatically as a major acquisition. Yet the change is usually for the worse. Shareholders of acquiring firms routinely lose money right on announcement of acquisitions.[8]

Sirower goes on to say that in many acquisitions, the acquirer is making a gift to the target's shareholders:

> When executives play the acquisition game, they pay, in addition to the current market price, an up-front premium for an uncertain stream of payoffs sometime in the future. Since shareholders do not have to pay a premium to buy the shares of the target on their own, these payoffs, the synergies, must represent something that shareholders cannot get on their own. They must mean improvements in performance greater than those already expected by the markets. If these synergies are not achieved, the acquisition premium is merely a gift from the shareholders of the acquirer to the shareholders of the target company.[9]

---

6. *Id.* at 122–23.
7. Bruner, APPLIED M&A, *infra* Table of References, at 44.
8. Mark L. Sirower, *Imagined Synergy: A Prescription for a No-Win Deal*, a chapter from THE SYNERGY TRAP, excerpted in MERGERS AND ACQUISITIONS 23 (Jan./Feb. 1998).
9. *Id.*

A 2011 report by J.P. Morgan Chase gives the following insights into the potential reasons for (1) the traditional negative stock price reaction for acquirers upon the announcement of an acquisition, and (2) recent observations of positive reactions to such announcements:

> The reaction of investors to acquisition announcements has been the subject of decades of academic debate. The traditional view is that acquirer stock prices have declined on announcement. Yet, there are several characteristics that were typically associated with well-received transactions: (i) paid in cash only; (ii) buying an asset or unit of another firm; (iii) acquirer has a strong track-record; and (iv) focused transactions (like-for-like acquisitions). In contrast, investors tended to punish acquirers for: (i) transactions paid for in stock; (ii) hostile transactions; (iii) diversifying transactions; and (iv) highly competitive/multiple bidder situations.
> It should [also] be noted . . . that the negative market performance of large stock acquisitions is typically affected by short-selling pressure from risk arbitrage funds and it is not always indicative of the quality of the transaction.[10]

When it comes to the combined returns to the shareholders of both the acquirer and target, Dean Bruner concludes that "[a]lmost all of the studies report positive combined returns. . . . The findings suggest that M&A does pay the investors of the combined buyer and target firms."[11]

Section 11:15, which focuses on valuation, explores the event study methodology for determining the returns of the shareholders of publicly held targets and acquirers upon the announcement of a merger or acquisition. The event study methodology was used in most of the analyses discussed in this section.

§ 1:5.2 Recent Evidence that Acquirer Shareholders Are Benefiting in More Mergers

As discussed above, in many mergers and acquisitions, the stock price of the acquirer falls after announcement of the deal. A November 2013 article reports that this trend may be reversing. The article states: "Dealogic's data show that the stock prices of acquirers have increased an average 2.4% between the day before and the day after a deal's announcement. That's the largest average increase since 2006."[11.1]

---

10. James Woolery, *The New Face of M&A: How a Trillion Dollars Will Change the Strategic Landscape*, Harvard Corp. Gov. Forum, *infra* Table of References (May 17, 2011).
11. Bruner, APPLIED M&A, *infra* Table of References, at 47.
11.1. *M&A Mystery: Why Are Takeover Prices Plummeting?*, WALL ST. J. (Nov. 25, 2013), www.wsj.com.

§ 1:6 Strategy for Approaching Mergers

As discussed in chapter 11, an acquisition is a capital budgeting decision, which should be made only if the transaction produces a positive net present value. Prior to getting to the point of evaluating a potential acquisition, a prospective acquirer should have a sound reason for considering the acquisition. While the role of business strategy in mergers and acquisitions, which is addressed extensively by business books dealing with mergers and acquisitions,[12] is beyond the coverage of this book, this section provides a rudimentary discussion of the Five Forces Analysis developed by Michael Porter.[13] Other common strategies include:

(1) focusing on "core competencies,"

(2) enhancing revenues or decreasing cost through the realization of synergies, and

(3) evaluating a firm's strengths, weaknesses, opportunities, and threats, which is known as a "SWOT" analysis.

The Five Forces Analysis is a commonly used strategy for identifying attractive industries and businesses for investment. The Five Forces Analysis is similar to the type of analysis done by antitrust authorities in evaluating an acquisition, and a Five Forces Analysis may lead to an acquisition that raises significant concerns with the antitrust authorities.

The Five Forces are:

(1) current competition from actual competitors,

(2) potential competition from potential competitors and substitutes,

(3) barriers to entry,

(4) supplier power, and

(5) buyer power.

The first factor teaches that the greatest threat to a business is current competition from actual competitors, and the less power current competitors have, the greater the profitability of the business. Therefore, generally an investment should not be made in an industry where the rivalry among the current competitors is strong. In other words, stay away from competitive markets.

The second factor focuses on the role in the current market of competition from potential competitors that are not currently in the

---

12. Bruner, APPLIED M&A, *infra* Table of References, at chapter 6 and Weston, TAKEOVERS, *infra* Table of References, at chapter 5.
13. Bruner, APPLIED M&A, *infra* Table of References, at 132–33.

market and of substitutes. Are there potential competitors on the wings of the market ready to enter? As the risk of potential competition increases, the attractiveness of the business decreases.

The third factor asks whether there are barriers to entry into the business. Barriers may include, for example, regulatory licenses, or patents, trademarks, or other intellectual property rights. Also, if a firm can, through learning, reduce its cost of operations compared to other firms in the industry (referred to as moving down the learning curve), the firm may be able to erect a barrier to entry. If barriers to entry are low, profitability will be low. Indeed, under what is known as the contestable markets theory, even if there is only one firm in the market, if there are no barriers to entry or exit, the firm will have to price at the competitive level. Otherwise, the firms on the edge of the market would immediately enter and drive the price down to the competitive level. The lesson here is that an acquisition should be made when there are barriers to entry into the business.

The fourth factor focuses on the power of the firm's suppliers. Are they in a position to squeeze the firm on the price of inputs or is the market for inputs competitive? The firm would obviously prefer that its suppliers operate in a competitive marketplace, because that would mean lower input prices.

The fifth factor focuses on the power of buyers or customers. Do buyers have power over price? If so they will be able to force down price, which is the case with firms like Wal-Mart. Obviously, a firm would prefer that its customers have no control over the price offered by the firm.

Under the Five Forces Analysis, an attractive target would be one where:

(1) competition from actual competitors is low,

(2) potential competitors cannot easily enter the market,

(3) barriers to entry are high,

(4) suppliers operate in a competitive market, and

(5) buyers cannot demand lower prices.

If the acquirer is already in the same line of business as such a target, an antitrust challenge to the acquisition may be likely.

§ 1:7 The Current M&A Scene

§ 1:7.1 Introduction

It is important for the M&A attorney or adviser to have a basic understanding of the macro-trends in M&A activity, and for this reason, this section presents, through a series of graphs and charts,

a macro-picture of the M&A marketplace, principally over the ten-year period from 2004 through 2013. This macro-picture will be updated each year to reflect developments in the past ten years. The financial press has periodic articles on M&A trends and several private firms provide analyses of this marketplace.

The following are three excellent sources of information on the M&A marketplace: Thomson Financial; the annual *Mergerstat Review*, published by FactSet Mergerstat LLC; and Deal Logic. Most of the information in the graphs comes from Thomson Financial and the *Mergerstat Review 2014*. Because these firms have different ways of reporting transactions, it is sometimes difficult to compare data provided by one source with similar data provided by another. However, in many cases the most important point is to understand the trends in certain activity rather than the absolute amounts of the activity, and utilizing the data provided by a particular firm for a multi-year period will provide relevant information on the trends.

§ 1:7.2 Strategic, Private Equity, and SPAC Deals

M&A deals can generally be divided into the following three categories:

(1) strategic deals,

(2) private equity deals, and

(3) special purpose acquisition company (SPAC) deals.

Strategic deals involve the acquisition by one operating company of another. Private equity deals involve the acquisition of a target by a private equity firm, that is, an investment vehicle that provides the equity financing for a deal significantly financed with debt. Chapter 14 examines special issues arising in private equity deals. SPACs are public companies organized for the purpose of making acquisitions. SPACs are addressed in chapter 6. Strategic and private equity deals constitute the bulk of transactions, and for that reason, the balance of the discussion here focuses on these deals.

The consideration paid in strategic deals is generally either stock of the acquirer or cash, and the cash may come from the incurrence of acquisition related debt by the acquirer. The consideration paid in private equity deals is almost always cash; although in some situations the target's shareholders in such deals retain an equity interest in the target. The deterioration in the credit markets that began in 2007 and 2008 made it more difficult for both strategic acquirers and private equity firms to raise cash for acquisitions in the debt markets. However, debt financing for acquisitions has become more available.

Because two operating firms are involved in a strategic acquisition, it is more likely that synergies will arise in such a transaction than in a private equity transaction. Consequently, a strategic acquirer may be able to offer more than a private equity buyer.

As a result of the credit crisis, several signed deals, particularly deals involving private equity firms, failed to close (see chapter 2), and there was significant litigation involving such transactions. As a result of these developments, private equity firms and strategic acquirers often negotiate to have their potential liability for failing to close the transaction limited to a reverse break-up fee. Such fees are examined in chapter 2.

Acquirers may also seek to have the closing of the transaction conditioned on the availability of financing; obviously, targets will resist such conditions. If such conditions are included in the acquisition agreement, the agreement often contains a significant reverse termination fee that would be payable, inter alia, in the event the financing condition is not satisfied.

If a target company is faced with competing bids from a private equity buyer and a strategic buyer, assuming there are no antitrust concerns, the target will often conclude that the risk that the deal will not close is greatest with the private equity buyer. In such a situation, it would be logical for the target to decide that it will only accept the offer from the private equity firm if the offer is significantly above the strategic buyer's offer. In other words, if there is increased risk of failing to close in private equity deals, then it is logical to expect that the price of such deals would have to increase relative to the price of strategic deals.

The following sections present data on both strategic and private equity deals, and except where otherwise noted, the data are presented on an aggregate basis.

§ 1:7.3 Past Trends in U.S. M&A Activity

Since the beginning of large scale mergers in the U.S. economy in the late 1800s, mergers have tended to occur in waves and economists have identified six waves. In testimony before the Senate Judiciary Committee during the fifth wave in 1998, the Chairperson of the Council of Economic Advisers discussed as follows the preceding four great merger waves:

- *The Great Merger Wave of the 1890s.* The first great merger wave (which occurred in the 1890s and the early 1900s) was the culmination of the trust movement, when numerous small and mid-sized firms were consolidated into single dominant firms in a number of industries. Examples include Standard Oil and U.S. Steel. One estimate is that this merger wave encompassed

at least 15% of all plants and employees in manufacturing at the turn of the century. An estimated 75% of merger-related firm disappearances occurred as a result of mergers involving at least five firms, and about a quarter involved ten or more firms at a time. The sharp decline in merger activity during 1903 and 1904 was probably related to the onset of a severe recession and the legal precedent for prohibiting market-dominating mergers under the antitrust laws that was established by the *Northern Securities* case.

- *The Roaring Twenties.* The merger movement of the 1920s saw the consolidation of many electric and gas utilities as well as manufacturing and minerals mergers. Some of the most prominent manufacturing mergers (such as the one that produced Bethlehem Steel) created relatively large number-two firms in industries previously dominated by one giant.
- *The "Go-Go" Sixties.* The 1960s conglomerate wave represented a deflection of the "urge to merge" away from horizontal (same-industry) mergers, perhaps due to stronger antitrust enforcement. The constant-dollar value of mergers in manufacturing and minerals surpassed the prior peak attained in 1899 (though it remained much smaller as a share of the economy). The 1960s boom was also fueled by a strong stock market and financial innovation (such as convertible preferred stocks and debentures). This merger wave ended with a decline in stock prices that was especially severe for companies that had aggressively pursued conglomerate mergers.
- *The Deal Decade of the 1980s.* Unlike other merger booms, this one began in a depressed stock market. With stock prices low relative to the cost of building new capacity, it appeared cheaper to expand by takeover. The 1980s boom was marked by an explosion of hostile takeovers and financial innovation (such as junk bonds and leveraged buyouts). The 1980s wave was unique in the prevalence of cash purchases (as opposed to acquisition through stock). Efforts to dismantle conglomerate firms put together in the previous wave and redeploy their assets more efficiently may have been an important driving force. Finally, the antitrust environment was more permissive and companies were more willing to attempt horizontal mergers.[14]

The fifth merger wave occurred in the late 1990s and ended with the burst of the tech bubble in 1999; it was driven mainly by strategic

---

14. Testimony of Dr. Janet Yellin, Chair, Council of Economic Advisers, Senate Judiciary Committee Hearings on Mergers and Corporate Consolidation (June 16, 1998) [hereinafter Yellin Testimony].

acquisitions. The sixth wave began in 2003 and came to an abrupt stop with the credit crisis of 2007 and 2008.

§ 1:7.4 Introduction to Recent Data on the M&A Marketplace

Sections 1:7.5 through 1:7.36 present recent data and information on the current state of the M&A marketplace. This section provides a brief guide to the manner in which the data and information are organized.

The following sections look at the macro impact of the M&A activity:

- § 1:7.5, Recent Trends in U.S. M&A Activity;
- § 1:7.6, Recent Trends in U.S. and Worldwide M&A Activity;
- § 1:7.7, Recent U.S. M&A Volume Related to Aggregate GDP;
- § 1:7.8, Recent U.S. M&A Volume As a Percentage of Aggregate GDP;
- § 1:7.9, Recent U.S. M&A Volume Related to the Investment Component of GDP; and
- § 1:7.10, Recent U.S. M&A Volume Related to the S&P 500.

The following sections provide data on structural issues in acquisitions, such as the type of consideration paid, premiums offered, capital raising by PE firms, and deal size:

- § 1:7.11, Recent U.S. M&A Activity by Type of Transaction;
- § 1:7.12, Recent P:E Ratios and Premiums Paid in U.S. Public Deals;
- § 1:7.13, Recent U.S. Payment Trends: Cash, Stock, Mixed, and Other;
- § 1:7.14, Recent Data on Acquisitions of Publicly Traded Companies;
- § 1:7.15, Recent Data on Acquisitions of Privately Owned Companies;
- § 1:7.16, Recent Private Equity Capital Raising and Equity Contributions;
- § 1:7.17, Recent Data on U.S. Deal Size;
- § 1:7.18, Recent Data on U.S. Regional Buyer Activity; and
- § 1:7.19, Recent Data on U.S. Regional Seller Activity.

The following sections provide information on takeover defenses, tender offers, and provisions of acquisition agreements:

- § 1:7.20, Recent Data on the Percentage of S&P 500 Companies with a Shareholder Rights Plan, Poison Pill;
- § 1:7.21, Recent Data on the Percentage of S&P 500 Companies with Various Types of Defensive Measures;
- § 1:7.22, Recent Data on U.S. Tender Offers, Contested and Uncontested;
- § 1:7.23, Recent Data on the Rise of Two-Step Transactions and the Top-Up Option;
- § 1:7.24, Recent Data on U.S. Termination Fees;
- § 1:7.25, Recent Data on Matching Rights in Negotiated Deals;
- § 1:7.26, Recent Data on Go-Shops in Negotiated Deals;
- § 1:7.27, Recent Information on Bankruptcies;
- § 1:7.28, Recent ABA Deal Point Studies;
- § 1:7.29 Recent Information on the Top Ten M&A Investment Banks and Law Firms Ranked by U.S. Deal Size; and
- § 1:7.30 Proxy Contest for the Five Year Period, 2009 to 2013.

The following sections look at cross border M&A transactions:

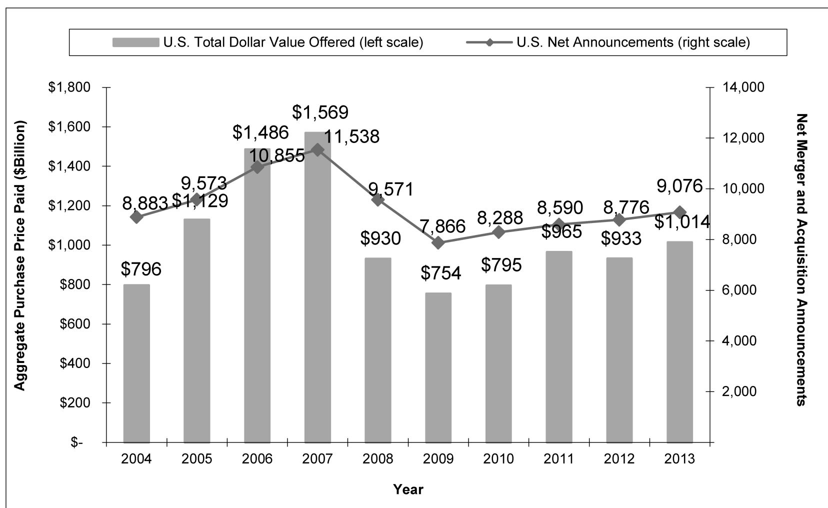
- § 1:7.31, Recent Data on Cross-Border M&A Activity;
- § 1:7.32, Recent Data on the Top Ten Foreign Buyer Countries;
- § 1:7.33, Recent Data on the Top Ten Foreign Seller Countries;
- § 1:7.34, The Trapped Foreign Income Problem and M&A; and
- § 1:7.35 The Inversion Problem, Pfizer and Beyond.

Finally, section 1:7.36 presents a Preliminary Report on M&A Activity in 2014, which shows that M&A seems to be coming back.

§ 1:7.5 Recent Trends in U.S. M&A Activity

Figure 1-1, *Trends in U.S. Mergers and Acquisition Activity 2004–2013*, shows both the dollar value of U.S. deals and the number of such deals for each year, and Figure 1-2, *Percent Change in U.S. Deals Volume and Percent Change in U.S. Number of Deals 2009–2013*, shows the number of deals during the 2009–2013 period above $100 million and above $1 billion.

Figure 1-1
Trends in U.S. Mergers and Acquisition Activity 2004–2013



Source: Thomson Reuters Data, as of May 2014

Figure 1-2
Percent Change in U.S. Deals Volume and Percent Change in U.S. Number of Deals 2009–2013

Year	2009	2010	2011	2012	2013
Percent Change in US Deals Volume	-18.96%	5.44%	21.37%	-3.32%	8.76%
Percent Change in No. of Deals	-17.81%	5.36%	3.64%	2.17%	3.42%
US $100 Million + Deals	535	912	932	1,013	1,016
US $ 1 Billion + Deals	90	161	147	187	177

Source: Thomson Reuters Data, as of May 2014

Figure 1-1 demonstrates that deal value grew steadily from 2004, with $796 billion in value, through 2007, with $1.5 trillion in value. Over the same period the number of deals jumped from 8,883 to 11,538. During this ten-year period from 2004 through 2013, the top year for both deal value and number of deals was 2007.

Although the subprime mortgage crisis began in the spring of 2007, M&A activity for 2007 was still quite robust. However, as shown on Figure 1-2, for 2009, (1) the percentage change in deal volume was a negative 18.96%, and (2) the percentage change in the number of deals was a negative 17.81%. The number of deals over $100 million and over $1 billion increased smartly from 2009 to 2010.

Figures 1-1 and 1-2 demonstrate that as a result of the credit crisis, there was not only a significant decrease in both the number and volume of deals (see Figure 1-1), but also a decrease in the average value of deals (see Figure 1-2).

Although deal value fell from about $1.5 trillion in 2007 to $.9 trillion in 2008, and the number of deals fell from 11,538 in 2007 to 9,571 in 2008, these declines were not as drastic as the 52.33% decline in deal value from 2000 to 2001 and the 29.79% drop in number of deals for that same period, as reported by Reuters.

A large number of announced deals in 2007 and 2008 failed to close for various reasons associated with the credit crisis, and this contributed to the decline in deal value from 2007 to 2008.

Notwithstanding the significant decline in M&A activity between 2007 and 2009, there was a significant increase in both volume and number of deals from 2009 through 2011. Several factors drove the increase in M&A activity during 2010 and 2011, including (1) low rates of interest and better functioning debt markets, (2) significant cash on corporate balance sheets and held by private equity firms, and (3) a rising stock market. As indicated in Figure 1-10, *Recent U.S. M&A Volume Related to S&P 500 Index 2004–2013*, M&A activity is generally correlated with increases and decreases in the stock market, and as indicated in Figure 1-13, *U.S. Payment Trends 2009–2013*, most M&A transactions are all-cash deals.

Figures 1-3, *Top Five Seller Industries by Number of Announcements 2013*, and Figure 1-4, *Top Five Seller Industries by Dollar Value of Announcements 2013*, provide information for 2013 from Mergerstat Review on the industries with the most M&A activity.

Figure 1-3

Top Five Seller Industries by Number of Announcements 2013

Rank	Industry	Total	Value ($ in Millions)
1	Computer Software, Supplies & Services	1,463	$62,792.1
2	Miscellaneous Services	1,219	$54,442.3
3	Brokerage, Investment & Mgmt. Consulting	675	$74,818.3
4	Wholesale & Distribution	431	$32,278.7
5	Construction Contractors & Eng. Svcs.	380	$9,915.7

Source: The Top Five Seller Industries, with Respect to the Number of Announcements in 2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 63

Figure 1-4

Top Five Seller Industries by Dollar Value of Announcements 2013

Rank	Industry	Total Announcements	Value ($ in Millions)
1	Communications	138	$149,423.4
2	Drugs, Medical Supplies & Equipment	274	$85,409.6
3	Brokerage, Investment & Mgmt. Consulting	675	$74,818.3
4	Computer Software, Supplies & Service	1,463	62,792.1
5	Miscellaneous Services	1,219	$54,442.3

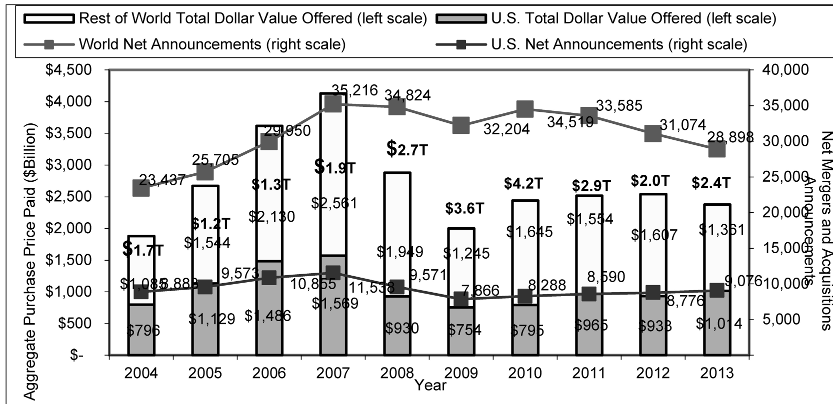
Source: The Top Five Seller Industries with Respect to the Dollar Value of Announcements in 2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 63

§ 1:7.6 Recent Trends in U.S. and Worldwide M&A Activity

Figure 1-5, *Trends in U.S. & Worldwide M&A Activity 2004–2013,* displays the M&A deal value and number of deals for both the United States and the "Rest of World" for the period from 2004 through 2013.

Figure 1-5

Trends in U.S. and Worldwide M&A Activity 2004–2013



Source: Thomson Reuters Data, as of May 2014

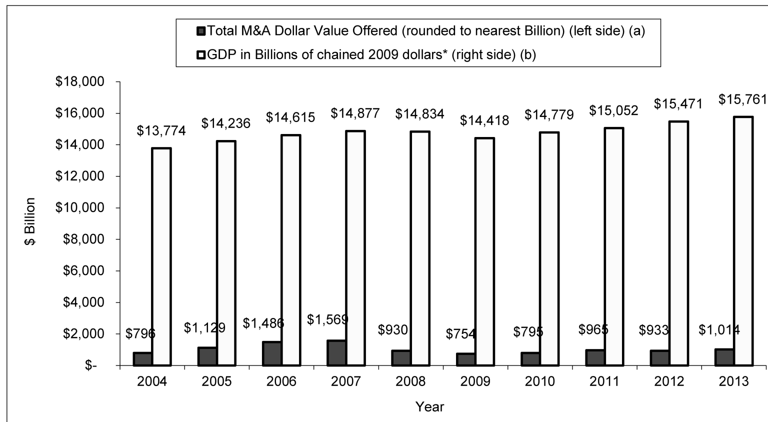
Figure 1-5 demonstrates that when domestic M&A activity is robust, foreign M&A activity also tends to be robust, and when domestic activity declines, as was the case in 2008 and 2009, foreign activity also declines. This may mean that M&A activity, whether domestic or foreign, is driven by the same factors. In every year, the number of foreign deals exceeded, by a wide margin, the number of U.S. deals, indicating that the average value of foreign deals is substantially less than the average value of U.S. deals.

§ 1:7.7 Recent U.S. M&A Volume Related to Aggregate GDP

Figure 1-6, *U.S. M&A Volume Related to Aggregate GDP 2004–2013*, shows the relationship between (1) aggregate gross domestic product (GDP), which is the aggregate purchases of new products and services by consumers, firms, governments, and foreign persons, for the period from 2004 through 2013, and (2) the dollar value of M&A activity for each of those years.

Figure 1-6

U.S. M&A Volume Related to Aggregate GDP 2004–2013



Sources: (a) Thomson Reuters Data, as of May 2014
(b) Bureau of Economic Analysis; Current Dollar and Real GDP; GDP in billions of chained 2009 dollars*
*Chained dollars is a term used to reflect real prices, adjusted for inflation, over a given period of time in reference to a base year.

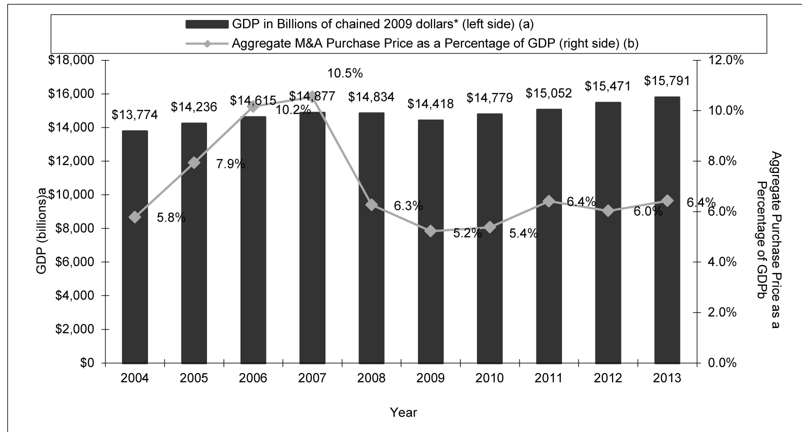
Figure 1-6 shows that the rate of growth of GDP increased significantly from 2004 through 2007, declined significantly from 2007 through 2009, and grew modestly from 2009 through 2013. As GDP grew briskly from 2004 through 2007, M&A deal value also grew briskly.

§ 1:7.8 Recent U.S. M&A Volume As a Percentage of Aggregate GDP

Figure 1-7, *U.S. M&A Volume As a Percentage of Aggregate GDP 2004–2013*, is another way of expressing the relationship between GDP and M&A deal value.

Figure 1-7

U.S. M&A Volume As a Percentage of Aggregate GDP 2004–2013



Sources: (a) Bureau of Economic Analysis; Current Dollar and Real GDP; GDP in billions of chained 2009 dollars
(b) Thomson Reuters Data, as of May 2014
*Chained dollars is a term used to reflect real prices, adjusted for inflation, over a given period of time in reference to a base year.

As seen in Figure 1-7, measured as a percentage of GDP, deal value has been on a roller coaster, with deal value (1) climbing from 5.8% of GDP in 2004, to 10.5% of GDP in 2007, (2) falling to 5.2% of GDP in 2009, (3) increasing to 6.4% of GDP in 2011, and (4) remaining steady through 2013. In testimony before Congress in 1998, the Chairperson of the Council of Economic Advisers said, "the last time merger activity was [12%] of GDP was during the Great Merger Wave at the turn of the [19th] century."[15]

The percentage decline in deal value from 2007 through 2009 accompanied a declining growth rate of GDP during that period, and the increase in the growth rate of deal value from 2004 to 2007 accompanied an accelerating growth rate of GDP during that period.

§ 1:7.9 Recent U.S. M&A Volume Related to Investment Component of GDP

Figure 1-8, *U.S. M&A Volume Related to the Nonresidential Investment Component of GDP 2004–2013*, presents the relationship

15. Yellin Testimony, *supra*.

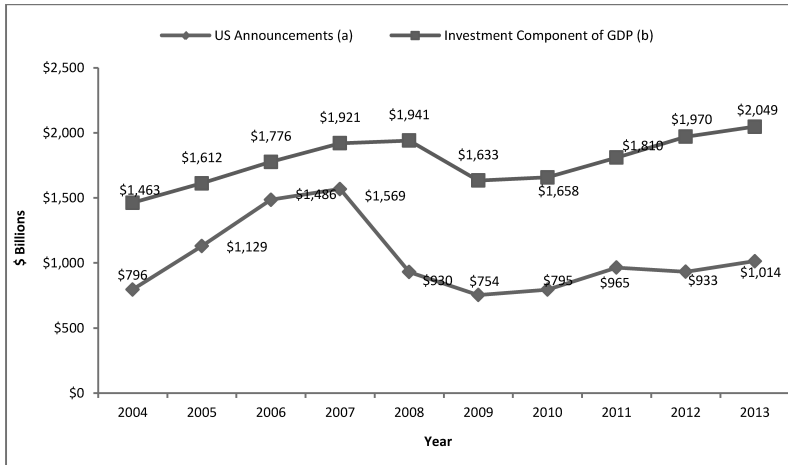
between (1) the volume of M&A announcements, and (2) the "Nonresidential Investment" component of GDP, which reflects the spending businesses make on equipment, software, and structures. Generally, this spending increases with a growing economy. Spending on Nonresidential Investment is a reflection of the decision of companies to build capacity.

Figure 1-9, *Recent U.S. M&A Percentage Change Related to Investment Component of GDP 2009–2013*, also presents the percentage changes in these two metrics for the period 2009 through 2013.

Figures 1-8 and 1-9 show that spending on M&A is much more volatile, on both the upside and the downside, than spending on Nonresidential Investment. For example, while spending on Nonresidential Investment fell 15.85% from 2008 to 2009, M&A volume reduced by 18.96%, and while spending on Nonresidential Investment increased just 1.52% from 2009 to 2010, M&A volume increased by 5.44%. This is another indication that a strong economy generally means an even stronger M&A marketplace, and a weak economy means an even weaker M&A marketplace.

Figure 1-8

Recent U.S. M&A Volume Related to the Nonresidential Investment Component of GDP 2004–2013



Sources: (a) Thomson Reuters Data, as of May 2014
(b) Economic Report of the President March 2014; Table B-2 Gross Domestic Product; GDP in billions of dollars

Figure 1-9

Recent U.S. M&A Percentage Change Related to Nonresidential Investment Component of GDP 2009–2013

Year	2009	2010	2011	2012	2013
Percentage Change in US Deals Volume (a)	-18.96%	5.44%	21.37%	-3.32%	8.76%
Percentage Change in Investment Component of GDP (b)	-15.85%	1.52%	9.15%	8.85%	4.01%

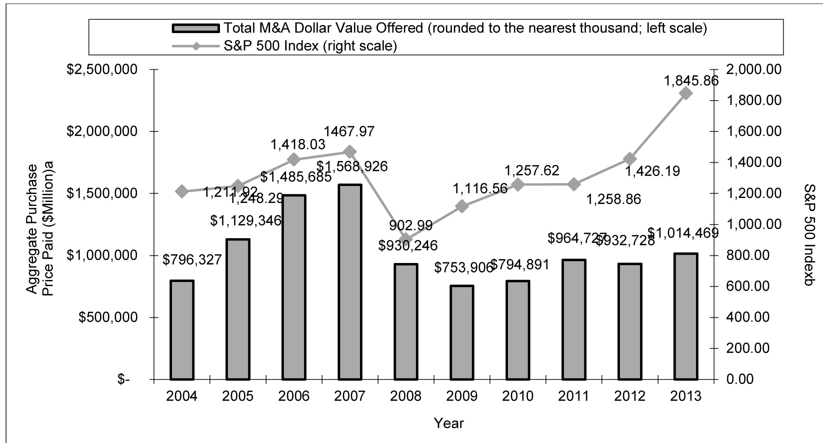
Sources: (a) Thomson Reuters Data, as of May 2014
(b) Economic Report of the President March 2014; Table B-2 Gross Domestic Product; GDP in billions of dollars

§ 1:7.10 Recent U.S. M&A Volume Related to the S&P 500

Figure 1-10, *U.S. M&A Volume Related to S&P 500 Index 2004–2013*, shows the aggregate value of U.S. M&A over this period as compared with movements in the S&P 500.

Figure 1-10

Recent U.S. M&A Volume Related to S&P 500 Index 2004–2013



Sources: (a) Thomson Reuters Data, as of May 2014
(b) Yahoo finance Historical Prices S&P 500 2001–2013
*S&P Composite Index on 500 Stocks

Figure 1-10 shows that movements in the value of M&A activity have generally been in lock-step with movements in the S&P 500. As the S&P 500 increased from 2004 through 2007, deal value increased, and as the S&P 500 decreased precipitously from 2007 through 2009, deal value also fell dramatically. This may be an indication that when the market is doing well, managers are more inclined to do M&A deals and to pay more in such deals.

§ 1:7.11 Recent U.S. M&A Activity by Type of Transaction

Figure 1-11, *Breakdown of U.S. M&A Activity by Type of Transaction: Number of Deals and Deal Value 2009–2013*, provides a breakdown on the type of M&A deals for the years 2009 through 2013. The deals are divided into the following categories:

1. Public Sellers,
2. Divestitures,
3. Privately Owned Sellers, and
4. Foreign Sellers.

Figure 1-11

Breakdown of U.S. M&A Activity by Type of Transaction: Number of Deals and Deal Value 2009–2013

Year	Public		Foreign		Divestitures		Private	
	No. of Deals	Deal Value ($ In Billions)	No. of Deals	Deal Value ($ In Billions)	No. of Deals	Deal Value ($ In Billions)	No. of Deals	Deal Value ($ In Billions)
2009	292	289.4	591	33.4	2440	195.0	3473	38.6
2010	364	259.7	970	60.7	3066	287.5	4716	83.0
2011	325	355.7	1059	100.0	2919	319.9	5216	94.2
2012	343	205.4	979	65.5	2958	378.2	5330	130.5
2013	314	284.4	939	59.4	2789	470.7	4735	80.0

Source: Composition of Net Merger and Acquisition Announcements, Mergerstat Review 2014, FactSet Mergerstat, LLC pg. 9, 12

Figure 1-11 shows that while the number of public deals is significantly less than the number of private deals, the deal value of public deals is significantly more than the deal value of private deals.

§ 1:7.12 Recent P:E Ratios and Premiums Paid in U.S. Public Deals

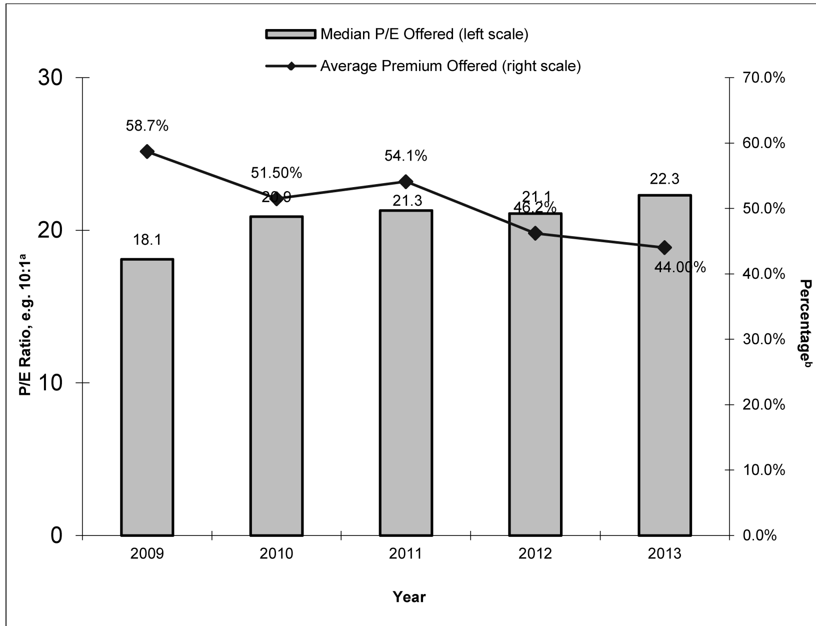
Figure 1-12, *U.S. P:E Ratio and Premiums Paid in Public Deals 2009–2013*, shows for acquisitions of publicly held targets in years 2009 through 2013 the following information:

(1) the ratio of the price offered by the acquirer to the target's earning, that is, the "Price to Earnings" (P:E) Ratio, and

(2) the amount by which the price offered by the acquirer exceeded the pre-offer trading price of the target, that is the "Premium Offered."

Figure 1-12

U.S. P:E Ratio and Premiums Paid in Public Deals 2009–2013



Sources: (a) Median P/E Offered: Public vs. Private 2004-2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 21
(b) Percent Premium Offered, 2004-2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 25

Figure 1-12 shows that for 2009 the median P:E offered was 18.1 to 1 (say 18 to 1), and the average premium offered was 58.7% (say 58%).

As discussed in chapter 11, which deals with valuation, another common deal metric is the comparison of (1) the firm's earnings before interest, taxes, depreciation, and amortization (EBITDA), with (2) the firm's total invested capital (TIC) or enterprise value (EV). Both TIC and EV mean the value of the firm's total debt (net of cash held) and equity. From 1997 through 2008, the average multiple of EV to EBITDA was 9.7 to 1.[16] This means that in the average deal during

16. Houlihan Lokey, M&A Market Overview, Jan. 2009, at Slide 14, *Transaction Multiples are Still High* [hereinafter Houlihan Lokey, *M&A Overview*, Jan. 2009].

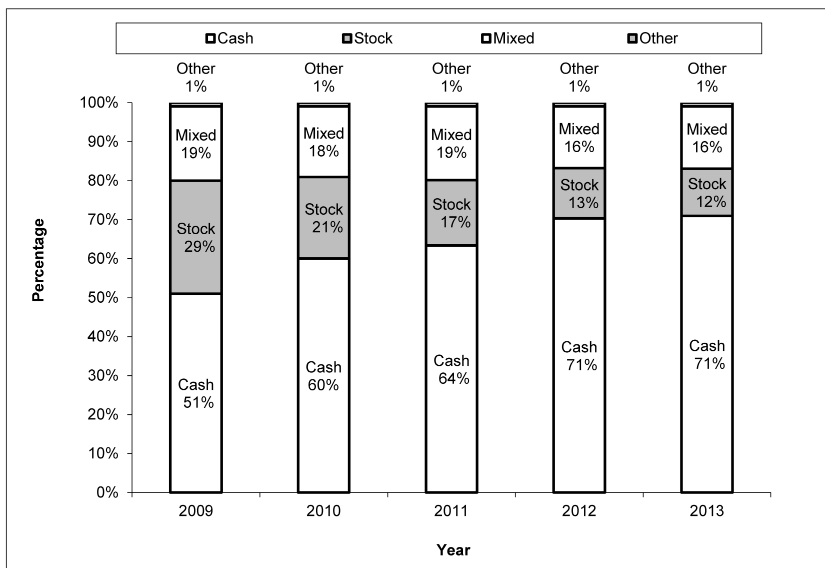
this period, the price paid plus the target's debt (net of cash held) was 9.7 times the target's EBITDA.

§ 1:7.13 Recent U.S. Payment Trends: Cash, Stock, Mixed, and Other

Figure 1-13, *U.S. Payment Trends 2009–2013*, sets out for the applicable years the percentage of transactions funded with the following types of consideration: cash, stock, mixed, and other.

Figure 1-13

U.S. Payment Trends 2009–2013



Source: Payment Trends 1993–2013, Mergerstat Review 2014, FactSet Mergerstat, LLC; pg. 16

Figure 1-13 shows that in each of the covered years cash was the sole consideration offered in between 51% and 71% of the transactions, and stock was the sole consideration in between 12% and 29% of the transactions. More stock was utilized in 2009 than in any of the other years, and this may be attributable to the difficulty companies had in issuing debt to raise cash for acquisitions. Also, the predominance of cash is attributable, at least in part, to the activity of private equity firms in the M&A marketplace, because in most acquisitions by private equity firms, cash is the sole consideration. Stock consideration is in many cases offered by a publicly held acquirer making a strategic acquisition.

As discussed in chapter 9, where cash is the consideration, the transaction is taxable to the target's shareholders and possibly at the corporate level on the target itself. If stock is the sole consideration, the transaction will generally qualify as a "reorganization" under the Internal Revenue Code, which provides for tax-deferred treatment to all shareholders who receive solely stock in a reorganization. Where the consideration is a mixture, for example, of cash and stock, the transaction may also qualify as a "reorganization"; however, the target's shareholders generally will be taxed on the cash (but not on the stock) received.

§ 1:7.14 Recent Data on Acquisitions of Publicly Traded Companies

Figure 1-14, *Acquisitions of Publicly Traded Companies 2009–2013*, provides the following information on acquisitions of publicly held targets in each of the years 2009 through 2013:

1. Total Number of Transactions,
2. Dollar Value Offered,
3. Method of Payment: Cash, Stock, Combination, or Other, and
4. Percentage of the Transactions That Are "Going Private" Deals.

As indicated in footnote (c) to Figure 1-14, a "going private" transaction "refers to an acquisition of a publicly traded company by a private investment group, individual, or a private company." Thus, these transactions include acquisitions of publicly held targets by private equity firms in leveraged buyouts, which are examined in chapter 14.

Figure 1-14
Acquisitions of Publicly Traded Companies 2009–2013

Year	Total Transactions (a)	Dollar Value offered (in billions) (a)	Method of Payment (b)				Going Private as a Percent of Public Takeovers (c)
			Cash	Stock	Combination	Other	
2009	292	$289	56%	26%	17%	1%	37.0%
2010	364	$260	70%	14%	15%	0%	42.3%
2011	325	$356	67%	17%	16%	0%	36.6%
2012	343	$205	66%	15%	19%	0%	42.6%
2013	314	284	64%	14%	22%	0%	41.4%

Sources: (a) Acquisitions of Publically Traded Companies 1999–2013, Mergerstat Review 2014, FactSet Mergerstat LLC, pg. 37
(b) Acquisitions of Publically Traded Companies by Method of Payment 2009–2013, Mergerstat Review 2013, FactSet Mergerstat LLC, pg. 38
(c) Going Private 2004–2013, Mergerstat Review 2014, FactSet Mergerstat LLC, pg. 43 ("'going private' refers to an acquisition of a publicly traded company by a private investment group, individual, or a private company.")

Figure 1-14 demonstrates that from 2009 through 2013, the number of acquisitions of public companies ranged from a low of 292 to a high of 364. In 2010, cash was the sole consideration in 70% of these deals, and in 2012 it was the sole consideration in only 66% of the deals. Also, in 2010, 42.3% of all acquisitions of public companies involved going private transactions, and in 2012 this percentage was 42.6%. For this period, these were the two highest years for going private transactions.

The general lesson here is that as acquisitions by private equity firms increase, the number of transactions in which cash is the sole consideration will increase. However, for 2009, stock was the sole consideration in more transactions than in any other year during this period. This indicates that although there was a substantial number of going private transactions in 2009, in strategic acquisitions, acquirers were using solely stock to a greater extent than in any other year during this period.

§ 1:7.15 Recent Data on Acquisitions of Privately Owned Companies

Figure 1-15, *Acquisitions of Privately Owned Companies 2009–2013*, provides for privately held targets the same information provided in Figure 1-14 for publicly held targets, except for information on going private, which is not applicable in acquisitions of closely held targets.

Figure 1-15

Acquisitions of Privately Owned Companies 2009–2013

Year	Total Transactions (a)	Total Dollar Value offered (a) (in billions)	Method of Payment (b)			
			Cash	Stock	Combination	Other
2009	3,473	$39	34%	43%	22%	1%
2010	4,716	$83	50%	27%	22%	1%
2011	5,216	$94	52%	23%	24%	1%
2012	5,330	$130	62%	17%	21%	0%
2013	4,735	80	60%	19%	21%	1%

Sources: (a) Acquisitions of Privately Owned Companies 2004–2013, Mergerstat Review 2014, FactSet Mergerstat LLC, pg. 46
(b) Acquisitions of Privately Owned Companies by Method of Payment 2009–2013, Mergerstat Review 2014, FactSet Mergerstat LLC, pg. 47

Figure 1-15 shows that the number of all-cash deals for closely held targets jumped from 34% in 2009 to 62% in 2012. This may be attributable to private equity firms acquiring privately held firms, particularly firms that are wholly owned by other private equity firms, so-called portfolio companies.

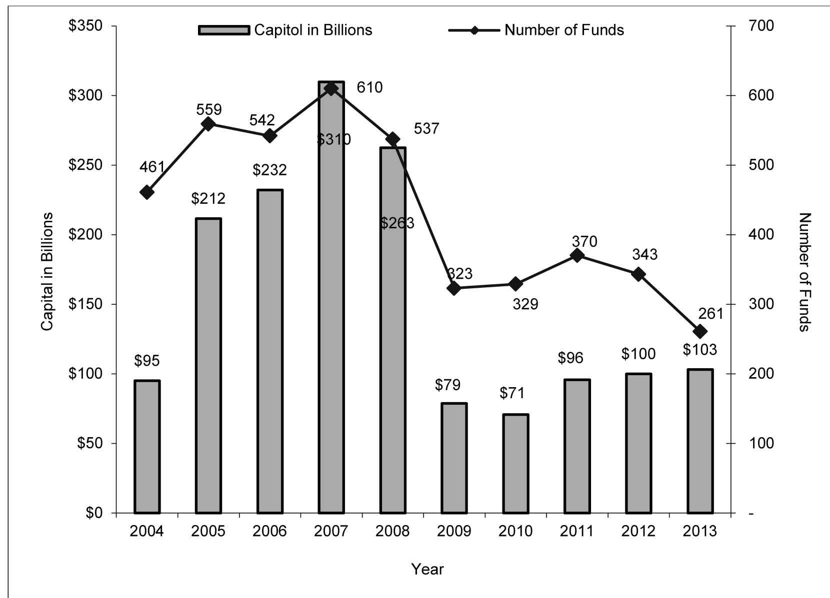
§ 1:7.16 Recent Private Equity Capital Raising and Equity Contributions

Figure 1-16, *Capital Raised by Private Equity Funds 2004–2013*, shows for each year from 2004 through 2013 the capital raised by

private equity firms and the number of private equity funds, and Figure 1-17, *Average Equity Contribution to U.S. LBOs 2004–2013*, shows the trend in average equity contributions to U.S. LBOs from 2004 to 2013.

Figure 1-16

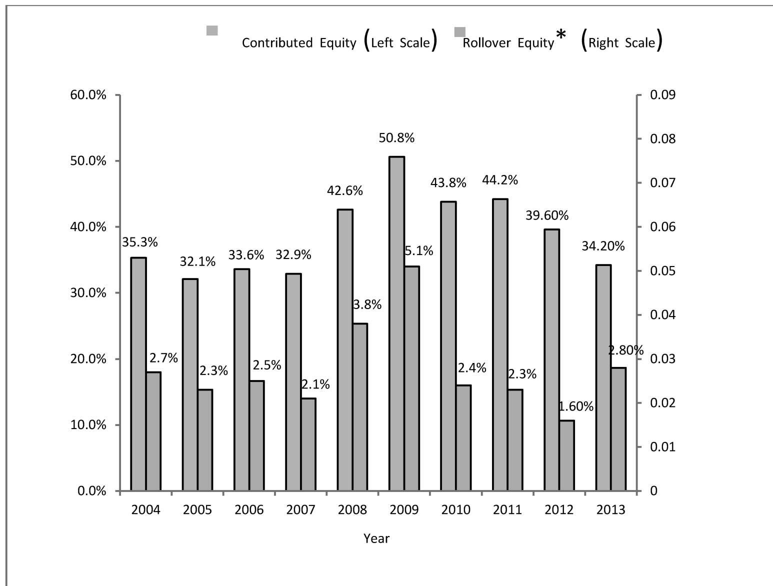
Capital Raised by Private Equity Funds 2004–2013



Source: Thomson Reuters; Fund Raising Report—U.S.—All PE, as of May 2014

Figure 1-17

Average Equity Contribution to U.S. LBOs 2004–2013



Source: Houlihan Lokey, RR Donnelley SEC Hot Topic Institute Market Overview September 2013, at 34, Citing: Standard and Poor's Q2 '13 Leveraged Buyout Review

*Rollover Equity is the equity contributed by the target's shareholders who participate in the acquisition side of the transaction.

Figure 1-16 shows that there was a steady growth in both the number of private equity funds and the capital raised between (1) 2004 when 461 funds raised $95 billion, and (2) 2007 when 610 funds raised $310 billion in capital. There was a significant drop in both the number of funds and the dollar value raised from 2007 to 2009. A slight rebound in the dollar value raised occurred from 2010 to 2013.

As discussed in chapter 14, private equity firms put this capital to work as equity investments in targets acquired in leveraged transactions. With the credit crisis of 2007 and 2008, private equity firms, as well as strategic buyers, found it more difficult to raise the debt funding for acquisition transactions. This has had a depressing effect on the number of private equity transactions and the expected returns on such transactions, because of the requirement that such transactions be funded more with equity than debt. For example, as demonstrated in Figure 1-17, from 2005 through 2007, the average equity

contribution in private equity deals was around 30%, whereas the average equity contribution was 50.8% in 2009 and 44.2% in 2011.

The higher contributions of equity both (1) reduce the risk of bankruptcy, and (2) reduce the potential return on equity; that is, with less risk comes less reward. For example, assume that a PE firm acquires a target for $100M. Assume further that the required equity contribution is in the alternative $30M and $50M. In the case of the $30M of equity, the debt is $70M, and in the case of the $50M of equity the debt is $50M. Also, assume that after five years the debt is still outstanding (only interest is required to be paid on the debt), and the target is sold for $110M. If the equity were $30M and the debt were $70M, the PE firm receives $40M after paying the debt, which is a 33% return on its $30M investment. On the other hand, if the equity were $50M and the debt were $50M, the PE firm receives $60M after paying the $50M of debt, a 20% return on its $50M equity investment.

Figure 1-17 also sets out the level of "rollover equity" in LBO deals. This is the equity contributed by the managers of the target who become owners in the acquisition vehicle. In 2009 rollover equity accounted for 5.1% of the equity, the highest level during this period. For 2012, it dropped back to 1.6%. Chapter 14, which addresses LBOs, discusses the issues in structuring rollover equity, which can be arranged on a tax-free basis.

A report by J.P. Morgan Chase gives the following analysis of the differences in the role of PE firms in the M&A market in (1) 2009 and 2010, and (2) pre-crisis years:

> The biggest difference between pre- and post-crisis M&A is that private equity plays a minor role relative to strategic buyers in [the 2010 market]. Pre-crisis, almost 40% of M&A volume was related to private equity transactions. [In 2010], private equity only constitutes 13% of transaction volume. Because most private equity transactions are executed with cash only, 77% of 2007 transactions were paid in cash, versus only 62% [in 2010].[17]

However, as shown in Figure 1-14, private equity accounted for approximately 42% of the acquisitions of publicly held firms.

The return of "cov-lite" bonds in 2011 and 2012 is an indication of the increasing availability of debt financing for private equity and other firms. Cov-lites are bonds that do not have onerous covenants. Corporate Control Alert provides the following analysis of the reasons for the return of cov-lites to the debt markets:

---

17. James Woolery, *The New Face of M&A: How a Trillion Dollars Will Change the Strategic Landscape*, Harvard Corp. Gov. Forum, *infra* Table of References (May 17, 2011).

> With supercharged loan markets returning [in 2010 and 2011], covenant-lite structures have emerged as well, raising questions again about whether their proliferation is a hazard or a boon. Fully 26% of first-lien institutional loans in 2011 qualify as covenant-lite, according to Standard & Poor's Leveraged Commentary & Data, compared with 5.1% in 2010. Banks traditionally insist on a range of covenants that allow them to intervene if a loan appears at risk.
>
> But in 2006, driven by demand from private equity firms and a dearth of corporate loan opportunities, banks scaled back onerous terms—for example, borrowers wouldn't be hassled if they failed to maintain capital ratios. These covenant-lite loans imposed restrictions only if the company wanted to incur more debt, known as incurrence covenants. New cov-lite deals all but disappeared in 2007 when the credit crunch descended . . . .[18]

Corporate Control Alert also reports that cov-lite loans performed better than covenant loans during the recent recession.[19]

§ 1:7.17 Recent Data on U.S. Deal Size

Figure 1-18, *Number of Deals by U.S. Deal Size 2009–2013*, presents the U.S. deal size for years 2009–2013, with transactions divided into the following categories:

1. Under $25 million,
2. $25 million to less than $50 million,
3. $50 million to less than $100 million,
4. $100 million to less than $1 billion, and
5. $1 billion and over.

---

18. *Cov-lite Comes Back*, Corporate Control Alert, *infra* Table of References, at 6 (Mar. 2011).
19. *Id.*

Figure 1-18
Number of Deals by U.S. Deal Size 2009–2013

Deal Size	2009	2010	2011	2012	2013
$25M or Less	460	971	831	771	1,005
Over $25M-$50M	151	224	259	245	289
Over $50M-$100M	111	244	205	236	279
Over $100M to Less than $1B	265	500	550	560	636
$1B and Over	68	132	142	161	161

Source: Comparison by Value of Deals 2009-2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, P 18

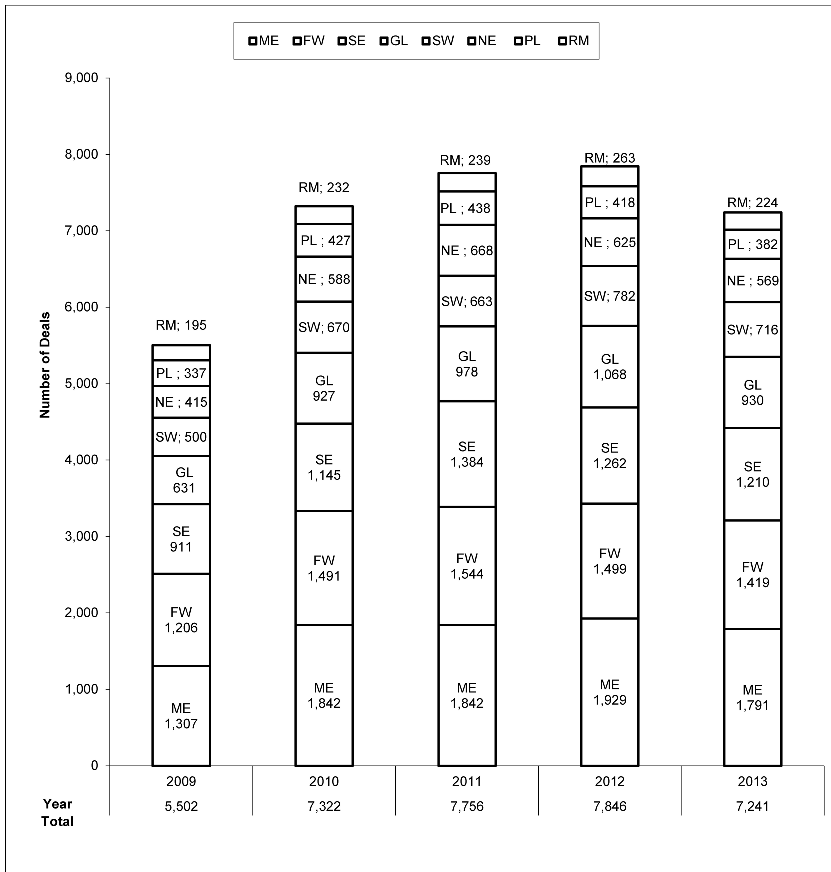
In all the years depicted in Figure 1-18, the most frequent deal size was under $25 million, and the second most frequent deal size was from $100 million to under $1 billion. As would be expected, the least frequent deal size was $1 billion and over.

§ 1:7.18 Recent Data on U.S. Regional Buyer Activity

Figure 1-19, *U.S. Regional Buyer Activity 2009–2013*, depicts the geographic base of U.S. acquirers for the years 2009 through 2013.

Figure 1-19

U.S. Regional Buyer Activity 2009–2013



Source: Regional Banking 2009–2013, Mergerstat Review 2014, FactSet Mergerstat, LLC; pg. 92

Key: ME= Mideast, FW=Far West, SE=Southeast, GL=Great Lakes, SW=Southwest, NE=New England, PL=Plains, & RM=Rocky Mtns.

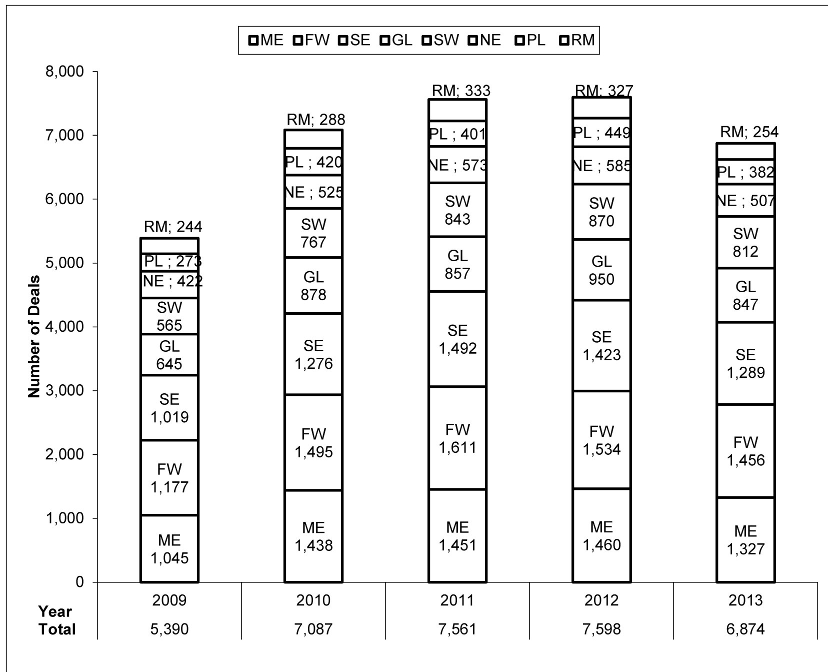
Figure 1-19 shows that the regions with the most acquirers were the Mideast, which includes New York; the Far West, which includes California; and the Southeast.

§ 1:7.19 Recent Data on U.S. Regional Seller Activity

Figure 1-20, *U.S. Regional Seller Activity 2009–2013*, depicts the geographic base of U.S. targets for the years 2009–2013.

Figure 1-20

U.S. Regional Seller Activity 2009–2013



Source: Regional Ranking 2009–2013, Mergerstat Review 2014; FactSet Mergerstat, LLC; pg. 92

Key: ME= Mideast, FW=Far West, SE=Southeast, GL=Great Lakes, SW=Southwest, NE=New England, PL=Plains, & RM=Rocky Mtns.

As was the case for U.S. acquirers, in each of the years shown in Figure 1-20, most targets were located in the Mideast and the Far West.

§ 1:7.20 Recent Data on the Percentage of S&P 500 Companies with a Shareholder Rights Plan, Poison Pill

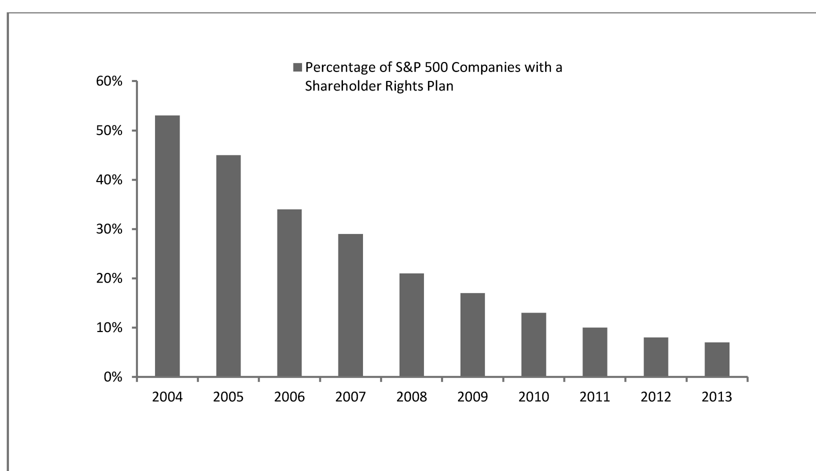
As discussed in chapter 5, shareholder rights plans, or poison pills, can act as an effective deterrent to a hostile takeover attempt. This was illustrated in the *Airgas* decisions discussed in chapter 5. Notwithstanding the effectiveness of these plans, Figure 1-21, *Percentage of S&P 500 Companies with a Shareholder Rights Plan 2004–2013*, shows that from 2004 through 2013, the percentage of S&P 500

companies with poison pills has steadily declined. However, as indicated in chapters 5 and 28, even though a company does not have a poison pill in place, its board can quickly adopt such a plan if the need arises.

For example, as demonstrated in Chapter 28, Allergan and Family Dollar Stores immediately adopted a poison pill upon learning that an activist investor controlled approximately 10% of its shares.

Figure 1-21

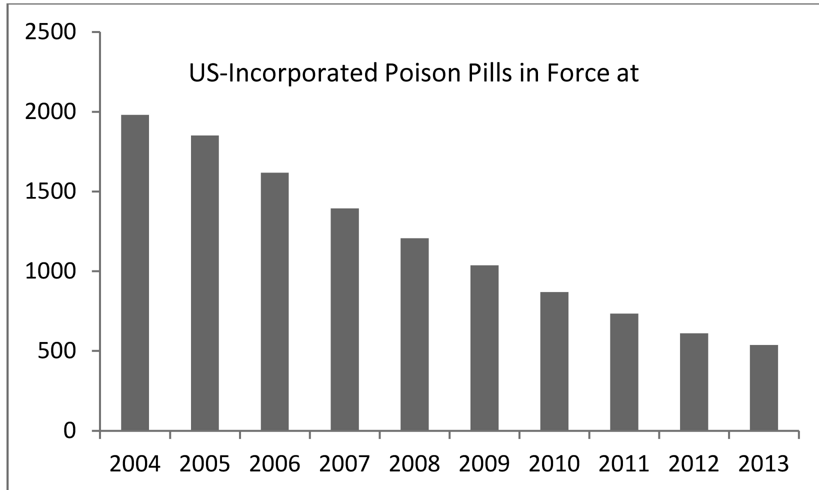
Percentage of S&P 500 Companies with a Shareholder Rights Plan 2004–2013



Source: Poison Pills In Force Year Over Year, SharkRepellent, 2014

Figure 1-22

Total Number of U.S.-Incorporated Companies with Poison Pills in Force at Year End



Source: Poison Pills In Force Year Over Year, SharkRepellent, 2014

§ 1:7.21 Recent Data on the Percentage of S&P 500 Companies with Various Types of Defensive Measures

Chapter 5 discusses various types of defensive measures in addition to the poison pill. Figure 1-23, *Percentage of Companies in the S&P 500 with Various Defensive Measures*, illustrates that defensive measures are not that prevalent among S&P 500 firms. Although, a board of a firm cannot unilaterally adopt many of these defensive measures, it can unilaterally adopt the most lethal defensive measure, the poison pill.

Figure 1-23

Percentage of Companies in the S&P 500 with Various Defensive Measures (2013)

Defensive Measure	***Percentage of S&P 500 Firms with the Measure***
Poison Pill	7.00%
Classified Board	10.99%
Majority Vote Standard to Elect Directors	85.41%
Plurality Vote Standard w/Resignation Policy	8.67%
Board Fills All Vacancies	78.65%
Shareholders Cannot Call Special Meetings	43.55%
No Action by Written Consent	70.40%
Fair Price Provision (company—charter/bylaws)	17.12%
Fair Price Provision (company or state)	21.14%
Supermajority Vote for Mergers	21.56%
Directors Removed Only for Cause	32.98%
Supermajority Vote to Remove Directors	22.83%
Expanded Constituency Provision (company—charter/bylaws)	7.19%
Expanded Constituency Provision (company or state)	28.12%
No Cumulative Voting	95.56%

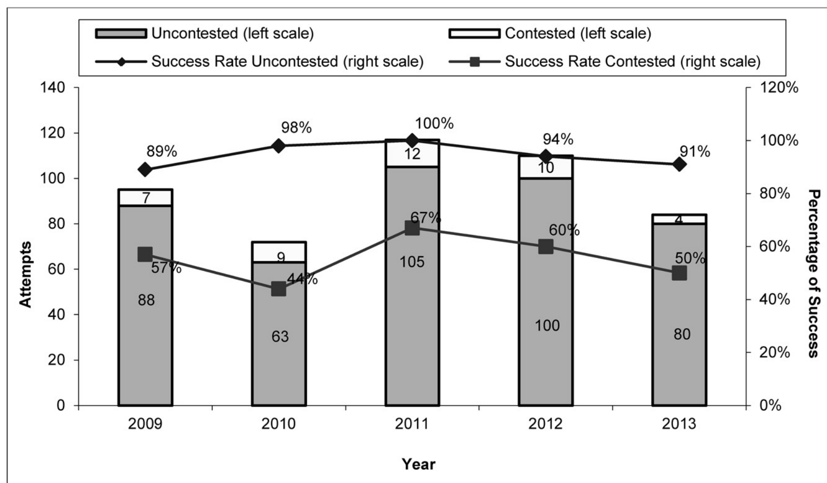
Source: Takeover Defense Trend Analysis 2013 Year End Snapshot, Mergerstat, SharkRepellant (2014)

§ 1:7.22 *Recent Data on U.S. Tender Offers, Contested and Uncontested*

Figure 1-24, *U.S. Tender Offers Contested and Uncontested 2009–2013*, shows the number of both hostile and uncontested (consensual) tender offers in years 2009 through 2013. In a hostile tender offer, the target's board opposes the tender offer, and in a consensual tender offer, the target's board generally enters into a merger agreement with the acquirer providing for a first-step tender offer by the acquirer, which is to be followed by a second-step merger. These two-step tender offer–merger transactions are addressed in both chapter 2, which deals with the drafting of acquisition agreements, and chapter 8, which addresses tender offers.

Figure 1-24

U.S. Tender Offers Contested and Uncontested 2009–2013



Source: Tender Offers for Publicly Traded Sellers 2004–2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 40

Although 2006 and 2007 are not displayed in Figure 1-24, from 2006 to 2007 the number of consensual tender offers jumped from 88 to 117, and this likely was attributable to the adoption, in 2006, of amendments to the SEC's "all holders, best price rule," which is examined in chapter 8.

In each of the years displayed, the success rate for hostile tender offers is significantly less than the success rate for consensual tender offers. This is largely attributable to the defensive measures a target's board may employ in opposing a hostile tender offer. These defensive tactics are explored in chapter 5, dealing with directors' fiduciary duties, and chapter 8, dealing with tender offers and related transactions.

The difficulties in completing a hostile acquisition are illustrated by (1) Microsoft's failure to acquire Yahoo! in a hostile bid, (2) CF Industries' year-long (but finally successful) battle to acquire Terra, and (3) Air Products' over year-long unsuccessful tender offer for Airgas, which had its staggered board and poison pill upheld by the Delaware courts. The Airgas staggered board and poison pill cases are discussed in chapter 5.

Information on proxy contests is provided in Section 1:7.30.

§ 1:7.23 Recent Data on the Rise of Two-Step Transactions and the Top-Up Option

Negotiated deals in the United States are generally structured as either (1) one-step mergers, or (2) two-step transactions, with a first-step consensual tender offer followed by a second-step short-form or long-form merger. Figure 1-25, *Percentage of One-Step and Two-Step Transactions 2008–2012*, presents the following data on one-step and two-step transactions for 2008 through 2012:

Figure 1-25

Percentage of One-Step and Two-Step Transactions 2008–2012

Year	One-Step Merger	Two-Step, Tender Offer followed by Merger
2008	51%	49%
2009	39%	61%
2010	64%	36%
2011	50%	50%
2012	56%	44%

Source: Slide 98 of the ABA, 2013 Strategic Buyer/Public Target M&A Deal Points Study

In this four-year period, two-step deals averaged around 50% of all public deals.

The principal reason for this rise in two-step transactions is speed. As discussed in chapter 8, the first step can be closed more quickly than a one-step transaction, because under Rule 14e-1(a) of the '34 Act, a tender offer can be closed after twenty business days. Also, recent amendments to Rule 14d-10 of the '34 Act (see chapter 8) reduced the concern that arrangements between the acquirer and the target's management could violate the "all holders, best price" rule, and this change reduced a significant barrier to negotiated tender offers. Two-step transactions generally will not be utilized where there are significant regulatory issues that could delay the closing of the first step.

Two-step transactions are examined in greater detail in chapters 2 and 4. As indicated there, many two-step deals have a "top-up option." These options kick-in, for example, when in the first-step tender offer the acquirer does not reach the 90% threshold needed to effectuate a short-form merger (see chapter 4). In such case, the top-up option gives the acquirer the right to purchase directly from the target the shares needed to reach the 90% threshold.

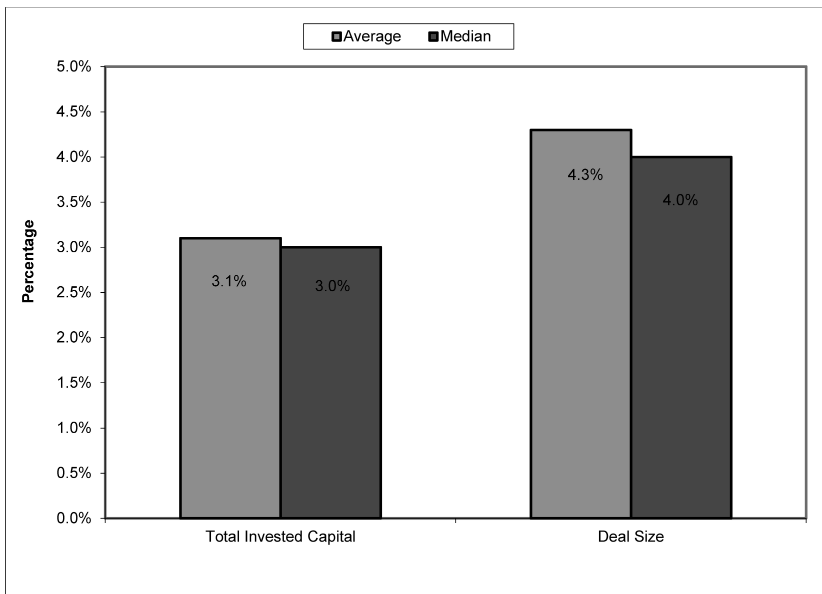
As discussed in chapter 4, the addition in 2013 of Section 251(h) to the Delaware General Corporation Law has, in many cases, eliminated the need for a top-up option.

§ 1:7.24 Recent Data on U.S. Termination Fees

As discussed in chapter 2, which deals with the drafting of acquisition agreements, and chapter 5, which deals with fiduciary duties, acquisition agreements in which a publicly held target is acquired will, in many instances, contain a termination fee. Such a fee is payable by the target to the acquirer if, for example, the target is acquired by a third party. Figure 1-26, *U.S. Termination Fees—Average and Median Percentage of Total Invested Capital and Deal Size 2013*, presents the average and median termination fees measured against total invested capital and deal size for 2013. Figure 1-27, *Transactions with or without Termination Fees of Publicly Traded Sellers, Privately Held Sellers, Divestitures, and Foreign Sellers 2013*, shows that 58.6% of public deals (but less than 1% of other deals) contained a termination fee.

Figure 1-26

U.S. Termination Fees—Average and Median Percentage of Total Invested Capital and Deal Size 2013



Source: Termination Fee Average and Median Percentage of Total Invested Capital and Deal Size 2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 57

Figure 1-27

Transactions with or without Termination Fees of Publicly Traded Sellers, Privately Held Sellers, Divestitures, and Foreign Sellers 2013

	Transactions	Transactions with Termination Fee	Percent of All Transactions
Publicly Traded Sellers	314	184	58.6%
Privately Held Sellers	4,735	16	0.3%
Divestitures	2,789	9	0.3%
Foreign Sellers	939	8	0.9%
Total	8,777	217	2.5%

Source: Distribution of Termination Fees 2013, Mergerstat Review 2014, FactSet Mergerstat, LLC pg. 57

As discussed in chapters 2 and 5, the law governing termination fees and other deal protection devices is still developing. The fundamental question is whether the termination fee serves to lock up the deal for the acquirer prior to the vote by the target's shareholders on the transaction and, therefore, results in a breach of the fiduciary duties of the target's directors. In examining this issue, courts will consider (1) if the level of fee is acceptable in a given circumstance, and (2) whether the fee should be measured against the size of the payment to the target's shareholders (that is, "deal size"), or against the value of the target's debt and equity (that is, "total invested capital"). As would be expected, Figure 1-26 shows that both the average and median termination fees are less when measured against total invested capital. As discussed in chapter 5, a termination fee in the range of 3% to 4% of deal size will likely be acceptable in Delaware in the absence of special circumstances.

As discussed in chapter 2, a growing number of transactions contain "reverse termination fees," which require the acquirer to pay the target if the transaction does not close because, for example, the acquirer cannot get financing. These fees do not present the same

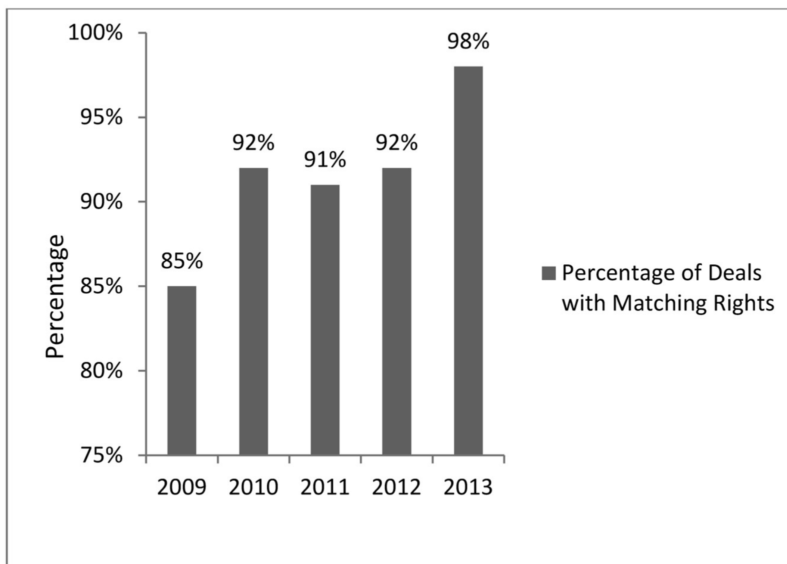
fiduciary duty issues surrounding a target's termination fee and, therefore, are in many cases higher than the 3% or 4% level.

§ 1:7.25 Recent Data on Matching Rights in Negotiated Deals

As discussed in chapter 5, the "no-shop" provisions of public company acquisition agreements will often contain a "matching" right, which gives the acquirer the right to match any competing offer. Figure 1-28, *Matching Rights in Negotiated Deals 2009–2013*, shows that matching rights have become quite prevalent in these acquisition agreements.

Figure 1-28

Matching Rights in Negotiated Deals 2009–2013



Source: Houlihan Lokey, RR Donnelley SEC Hot Topic Institute Market Overview at 40 (September 2013), Citing: FactSet

For 2010, these matching rights were present in 92% of transactions with a strategic buyer and in 99% of transactions with a financial buyer.[20]

20. Houlihan Lokey, Market Trends Meeting at the ABA M&A Committee Meeting at 63 (Feb. 2012) Citing: FactSet.

§ 1:7.26 Recent Data on Go-Shops in Negotiated Deals

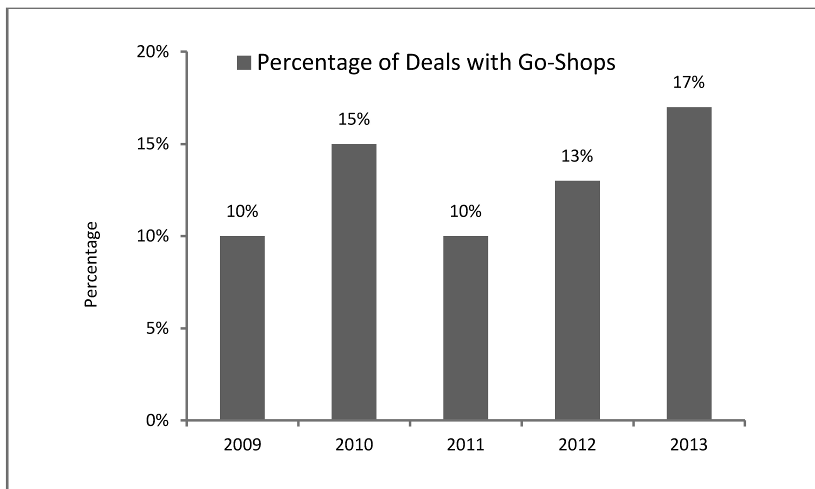
Chapter 5 discusses the use of "go-shops" in public company acquisition agreements. These provisions may be employed by a target's board to satisfy its *Revlon* duties to get the best price reasonably available where the target has negotiated with, and entered into an acquisition agreement with, a single bidder.

Unlike the "no-shop," the "go-shop" specifically authorizes the target to seek other purchasers for a specified period. In general, the termination fee the target is required to pay if it terminates the first acquisition agreement and goes with a competing bidder is lower for topping transactions arising during the go-shop period than for such transactions arising after the go-shop period.

Figure 1-29, *Go-Shop Rights in Negotiated Deals 2009–2013*, shows that for 2013, the year during this five-year period with the highest number of go-shops, these provisions were present in only 17% of public company deals. Generally go-shops are more prevalent in deals with financial buyers than in deals with strategic buyers.

Figure 1-29

Go-Shop Rights in Negotiated Deals 2009–2013



Source: Houlihan Lokey, RR Donnelley SEC Hot Topic Institute Market Overview, September 2013, at 37, Citing: FactSet

Go-shops may be effective in generating competing bids.

§ 1:7.27 Recent Information on Bankruptcies

Corporate bankruptcies increase in recessionary times. For example, in the 2002 recession, corporate bankruptcies increased from a near zero level to about 4% of M&A deal volume, and from 2008 to 2009 corporate bankruptcies increased from approximately 1% of M&A deal volume to approximately 11% of such volume.[21] Chapter 16 explores acquisitions of bankrupt companies.

§ 1:7.28 Recent ABA Deal Point Studies

The ABA Deal Point Studies, *infra* Table of References, which examine trends in various types of M&A transactions, are discussed throughout this book, particularly in chapter 2, General Principles in Drafting an Acquisition Agreement—Merger Agreement, Asset Acquisition Agreement, and Stock Purchase Agreement, and chapter 5, Fiduciary Duties of Directors, Officers, and Controlling Shareholders. These very valuable resources are periodically updated, and the latest version of these studies should be reviewed. The studies are available on the website of ABA, Committee on Mergers and Acquisitions.

§ 1:7.29 Recent Information on the Top Ten M&A Investment Banks and Law Firms Ranked by U.S. Deal Size

Figure 1-30, *Top 10 M&A Investment Banking Firms and Law Firms Ranked by U.S. Deal Volume 2013*, sets out the top ten investment banking and law firms ranked by U.S. M&A deal volume for 2013.

---

21. Thomson Reuters, *Mergers & Acquisitions Review* 8 (Fourth Quarter 2009, Financial Advisors).

Figure 1-30

Top 10 M&A Investment Banking Firms and Law Firms Ranked by U.S. Deal Volume 2013

	Investment Banker Firms	Law Firm
1	JPMorgan Chase & Co.	Wachtell, Lipton, Rosen & Katz
2	Goldman Sachs & Co.	Davis Polk & Wardell LLP
3	Bank of America Merrill Lynch	Simpson Thacher & Bartlett LLP
4	Morgan Stanley	Weil, Gotshal & Manges LLP
5	Barclays Plc	Jones Day LP
6	UBS AG	Hogan Lovells
7	Deutsche Bank AG	Slaughter & May Ltd.
8	Citigroup	Debecoise & Plimpton LLP
9	Guggenheim Capital LLC	Sullivan & Cromwell LLP
10	Lazard	Macfarlanes LLP

Source: 2013 Mergerstat Financial Advisor Banking Rank by Total Value, MergerStat 2014; FactSet Mergerstat, LLC; pgs. 54–55

Two traditional investment banking firms, Goldman Sachs and Morgan Stanley, are at or near to top of the list, and except for Guggenheim at number nine and Lazard at number ten, the other investment banking firms are divisions of traditional bank holding companies.

§ 1:7.30 *Proxy Contest for the Five Year Period, 2009 to 2013*

Georgeson, a leading proxy solicitor, publishes an *Annual Corporate Governance Review.* The *2013 Annual Review* presents the following statistics on the number of proxy contest in each of the years during the five-year period from 2009 through 2013:

Figure 1-31

Number of Proxy Contest, 2009–2013

Year	Number of Contests
2009	57
2010	35
2011	20
2012	34
2013	37

Source: Figure 21, Georgeson, 2013 Annual Corporate Governance Review

An analysis of the statistics in the *2013 Annual Review* for the 37 proxy contests occurring in 2013 shows that management won 9 of the contests and the dissident won 8. The full data on the Winners is shown in the following table.

Figure 1-32

Results of the 37 Proxy Contests in 2013

Winner	**Number**
Management	9
Settled	9
Dissident	8
Withdrawn	4
Split	2
Pending	5
Total	37

Source: Figure 22, Georgeson, 2013 Annual Corporate Governance Review

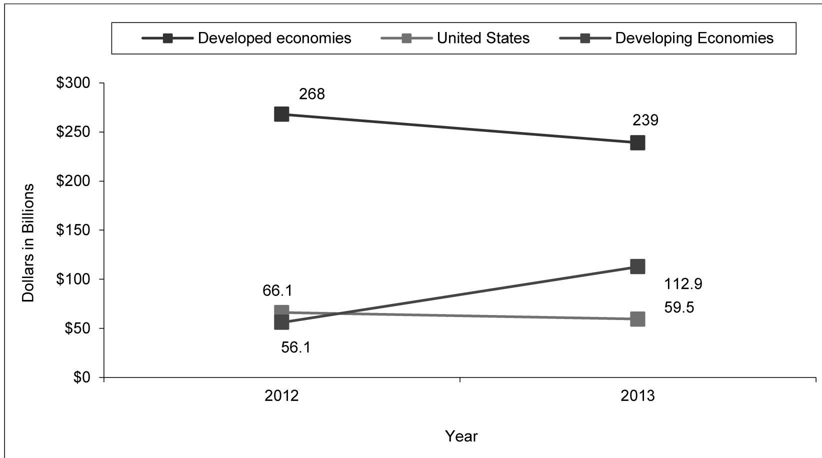
The above data shows that in seventeen of the contests, the dissident either won (eight) or settled (nine), which would seem to be pretty good results for the dissidents.

§ 1:7.31 Recent Data on Cross-Border M&A Activity

Figure 1-33, *Cross-Border M&As by Major Economy 2012–2013*, which is based on data provided by the U.N. Conference on Trade and Development (UNCTAD), shows the value of cross-border M&As for 2012 and 2013 for the following economies: Developed Economies, the United States, and Developing Economies.

Figure 1-33

Cross-Border M&As by Major Economy 2012–2013



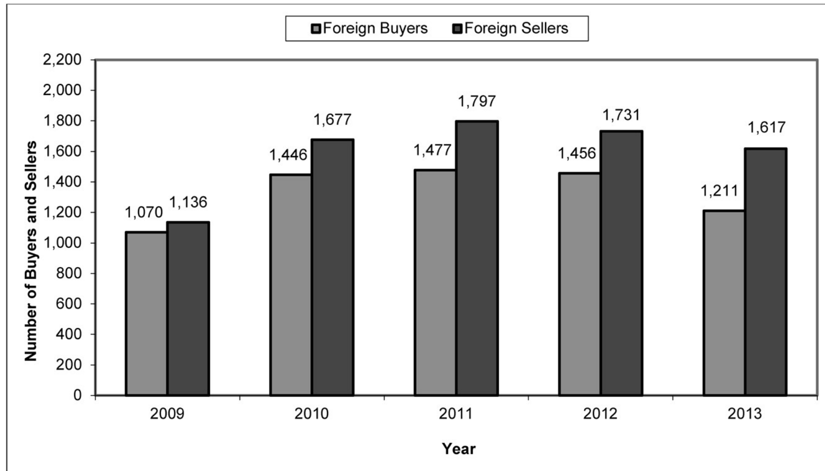
Source: UNCTAD, World Investment Report 2014.

Figure 1-33 shows that from 2012 through 2013, there was a sharp decline in cross-border M&A in developed economies, a slight decline in the U.S. and a sharp increase in developing countries.

Figure 1-34, *Cross-Border M&A Foreign Buyers of U.S. Targets and Foreign Sellers to U.S. Acquirers 2009–2013*, shows for years 2009 through 2013, the number of foreign acquirers of U.S. targets in inbound cross-border M&A transactions, and the number of U.S. acquirers of foreign targets in outbound M&A deals. Chapters 19 through 22 address various aspects of inbound and outbound transactions.

Figure 1-34

Cross-Border M&A Foreign Buyers of U.S. Targets and Foreign Sellers to U.S. Acquirers 2009–2013



Source: Foreign Acquisitions of U.S. Companies 1999–2013, U.S. Acquisitions of Foreign Businesses 1999–2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pgs. 96 & 52

Figure 1-34 shows that, although there was a significant decrease in the number of inbound and outbound transactions in 2009, the level of cross border activity has increased since then. Also, Figure 1-34 shows that although in each of these years the number of foreign targets of U.S. acquirers exceeds the number of foreign acquirers of U.S. targets, the numbers are closely balanced.

If the dollar becomes weaker (that is, it takes less of a foreign currency to purchase a dollar) when measured against the currencies of the major trading partners of the United States, then (1) it will be cheaper for potential acquirers located in such countries to buy U.S. targets, and (2) at the same time, it will become more expensive for potential U.S. acquirers to buy targets located in such countries. The reverse is true if the dollar becomes stronger (that is, it takes more of a foreign currency to purchase a dollar).

§ 1:7.32 Recent Data on the Top Ten Foreign Buyer Countries

Figure 1-35, *Top 10 Foreign Buyer Countries by Deal Volume 2012–2013*, presents for 2012 and 2013 the top ten countries as measured by deal volume in which foreign acquirers are located.

Figure 1-35

Top 10 Foreign Buyer Countries by Deal Volume 2012–2013

2012			2013		
1	Japan	46.3 Billion	1	United Kingdom	31.1 Billion
2	Canada	27.0 Billion	2	Canada	29.4 Billion
3	United Kingdom	26.3 Billion	3	France	22.0 Billion
4	Switzerland	19.7 Billion	4	Singapore	8.3 Billion
5	Germany	14.8 Billion	5	China	7.5 Billion
6	Netherlands	7.2 Billion	6	Japan	6.9 Billion
7	China	4.5 Billion	7	Ireland	6.1 Billion
8	India	4.5 Billion	8	Netherlands	5.6 Billion
9	Indonesia	2.5 Billion	9	Germany	5.3 Billion
10	France	2.4 Billion	10	Cayman Islands	4.7 Billion

Source: Foreign Buyers, Dollar Value by Country 2009–2013 Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 100–101

Two English speaking countries, the United Kingdom and Canada, are at or near the top of the list in both 2012 and 2013.

§ 1:7.33 Recent Data on the Top Ten Foreign Seller Countries

Figure 1-36, *Top 10 Foreign Seller Countries by Deal Volume 2012–2013*, presents for 2012 and 2013 the top ten countries as measured by deal volume in which foreign targets are located.

Figure 1-36

Top 10 Foreign Seller Countries by Deal Volume 2012–2013

2012			2013		
1	Ireland	11.6 Billion	1	Ireland	13.6 Billion
2	Canada	9.2 Billion	2	Japan	10.1 Billion
3	Australia	6.6 Billion	3	United Kingdom	5.8 Billion
4	Brazil	4.7 Billion	4	Canada	5.7 Billion
5	Germany	4.5 Billion	5	Netherlands	4.7 Billion
6	United Kingdom	4.2 Billion	6	Australia	3.0 Billion
7	Israel	3.3 Billion	7	Israel	2.8 Billion
8	Japan	2.7 Billion	8	Brazil	2.3 Billion
9	Belgium	2.7 Billion	9	Spain	1.9 Billion
10	Mexico	2.4 Billion	10	France	1.8 Billion

Source: Foreign Sellers, Dollar Value by Country 2009–2013, Mergerstat Review 2014, FactSet Mergerstat, LLC, pg. 104–105

Again, the United Kingdom and Canada are at or near the top of the list for both years. The presence of Ireland as the number one seller country in both 2012 and 2013 could be attributable, in part, to inversion transactions with U.S. firms. These transactions are introduced below and are discussed in detail in Chapter 22.

§ 1:7.34 The Trapped Foreign Income Problem and M&A

Another factor propelling outbound M&A is the need for U.S. companies with significant off-shore operations to reinvest the profits from those operations off-shore in order to avoid the U.S. tax that would apply to such earnings if they are repatriated to the U.S. A J.P. Morgan Chase report elaborates on this effect as follows:

> U.S. firms have accumulated a record amount of cash, but a sizable portion of this cash is "trapped" offshore (cannot be repatriated to the U.S. without incurring incremental taxes). By acquiring foreign targets, firms can effectively use their trapped cash to pursue growth opportunities abroad without repatriation tax consequences. This is especially valuable when the return of cash as an asset continues to be minimal in today's low interest rate environment, leading to a significant negative-carry cost. Indeed, in several recent cross-border transactions, analysts commented favorably on foreign acquisitions by U.S. firms that utilize offshore cash.[22]

The author of this book has written several articles suggesting that the current deferral system for taxing foreign source income, which leads to the "trapped" off-shore income, be replaced with an imputation system that would tax foreign earnings of controlled foreign corporations on a current basis.[23] The adoption of such an imputation system would have several salutary effects, including, (1) raising revenues that could be used to lower the corporate tax rate for all corporations, and (2) elimination of the "trapping" effect that encourages foreign acquisitions over U.S. acquisitions.

§ 1:7.35 The Inversion Problem, Pfizer and Beyond

As pointed out in section 22:7, U.S. companies have been avoiding the U.S. system for taxing foreign income by inverting. In an inversion transaction, a U.S. company and a foreign company merge with the final result being a foreign holding company owning the stock of the U.S. firm and the foreign firm. To make the inversion successful in avoiding U.S. tax on foreign earnings, it is key that the shareholders of the foreign company end up with more than 20% of the stock of the foreign holding company.

Recently, many U.S. companies have inverted, or like Pfizer are trying to invert, in what are referred to as New Inversions. These transactions, with an illustration of the 2014 New Inversion involving Endo, are discussed in section 22:7.1[G] and in a June 2014 article by this author.[24]

---

22. James Woolery, *The New Face of M&A: How a Trillion Dollars Will Change the Strategic Landscape*, Harvard Corp. Gov. Forum, *infra* Table of References (May 17, 2011).
23. *See e.g.*, Samuel C. Thompson Jr., *Logic Says No to Options Y, Z, And C, but Yes to Imputation*, 143 Tax Notes 579 (May 5, 2014) and Samuel C. Thompson, Jr. *An Imputation System for Taxing Foreign-Source Income,* 61 TAX NOTES INT'L 691 (Feb. 28, 2011).
24. Samuel C. Thompson Jr., *New Inversions, the 'Joe Frazier Left Hook,' the IRS Notice, and Pfizer*, 143 TAX NOTES 1413 (June 23, 2014).

§ 1:7.36 Preliminary Report on M&A Activity in 2014

This section provides a brief report on M&A activity during the early part of 2014. The next supplement will have a more complete update on the activity in 2014. As indicated by the following report by MergerMarket for April 2014, M&A activity in the U.S. was quite robust during the first part of the year:

- U.S. M&A saw deals valued at U.S.$ 277.8bn soaring 55.9% above Q1 2013 (U.S.$ 178.2bn) and 24.3% over Q4 2013 (U.S.$ 223.5bn)
- Q1 2014 marked the highest valued first-quarter since Q1 2007 (U.S.$ 361.4bn)
- The jump can be attributed to the announcement of four mega-deals worth a combined total of U.S.$ 124.2bn during the first three months of the year
- The average deal size in the U.S. stood at U.S.$ 632.8m in Q1 2014, the highest Q1 average since the beginning of 2009 and 35.3% higher than Q1 2013's U.S.$ 467.7m.[25]

An article in the May 5, 2014 issue of Mergers & Acquisitions Law Reports presents the same basic picture:

> The value of takeovers announced in 2014 hit the $1 trillion mark April 28, reaching that level at the fastest pace in seven years.
>
> That threshold was crossed 54 days earlier than in 2013, after more than $300 billion in purchases were announced by companies [like] Valeant Pharmaceuticals International Inc. [whose bid for Allergan is discussed in chapter 28.] . . .
>
> Chief executive officers, with more than $4 trillion in cash on company balance sheets globally, have gone from being wary of making big deals to facing pressure to strike deals or be beat to opportunities by their major rivals[.][26]

§ 1:8 Introduction to Corporate Governance Issues Generally

§ 1:8.1 Background

Corporate governance issues are obviously very important, particularly for publicly held firms. As explained by John Madden, a partner at

---

25. Mergermarket, Merger Market M&A Trend Report (April 2014), at 8.
26. Jodi Xu, Will Robinson and Tara Lachapelle, *Merger Activity: Megadeals Drive Takeover Activity Beyond the $1 Trillion Mark for 2014*, Mergers & Acquisitions Law Report (May 5, 2014).

Shearman & Sterling, the growing influence of institutional shareholders has contributed to the emphasis on corporate governance:

> As the shareholder base has largely consolidated into the institutional investor community [in 1950 institutions owned approximately 10% of stocks, today they own nearly 70%] and those investors have become more organized and focused on exerting the influence inherent in their substantial ownership stakes, we have seen in recent years an accelerating shift in the "balance of authority" exercised by boards and shareholders in the corporate decisionmaking process.[27]

Some governance experts have argued that corporate governance should be designed to foster the long-term success of the corporation. John Madden has the following interesting insight on this principle:

> [M]anaging for long-term and short-term results are not inherently inconsistent and many successful CEOs will argue that one must manage for both objectives. In some cases, current strong market performance in the stock can be a reflection of confidence in the long-term plan and, on the other hand, poor current stock performance may reflect a distinct lack of confidence in the longer-term strategy. To the extent a company may be facing this kind of tension, the board's role is to ensure that the company has the right long-term strategy and, having done so, to build support among the shareholder constituency for that strategy.[28]

The structure of a firm's corporate governance can have an impact on the attractiveness of a firm as a takeover candidate. For example, Martin Lipton, the inventor of the poison pill defensive tactic, reports that as a result of recent changes in corporate governance, activist shareholders, who often invest in corporations with the purpose of encouraging the board to sell the corporation, likely can target larger corporations. Mr. Lipton explains:

> Nelson Peltz, one of the most successful of the activist investors, said that recent changes in corporate governance would enable him to make investments in the heretofore "untouchables"—companies with market capitalizations over $50 billion.[29]

The purpose of this section is to provide a brief introduction to corporate governance issues facing publicly held U.S. corporations.

---

27. John J. Madden, *The Shifting Landscape of Corporate Governance, and Four Steps Boards Should Take in an Era of Shareholder Ascendancy*, 14 MERGERS & ACQUISITIONS L. REP. 306 (Feb. 28, 2011).
28. *Id.*
29. Martin Lipton, *Activists Target Companies with Market Caps Over $50 Billion*, Wachtell, Lipton, Rosen & Katz (Apr. 5, 2011).

Most of the issues introduced here are discussed in greater detail in subsequent chapters. In approaching corporate governance issues it is necessary to focus on both state and federal law.

§ 1:8.2 Overview of Corporate Governance at the State Level

At the state level, Delaware law, which is the principal focus of this treatise, provides in section 141(a) that the "business and affairs of every [Delaware] corporation . . . shall be managed by or under the direction of a board of directors." When adopting a poison pill (see chapter 5), the directors of a Delaware corporation are acting, in part, under section 141(a).

Notwithstanding the broad grant of authority in section 141(a), as discussed in chapter 5, directors of Delaware corporations are subject to fiduciary duties of care and loyalty, which were developed by the common law. And, the actions of directors are generally protected by the business judgment rule, a standard of review developed by the common law. However, in certain cases one of the other common law developed standards of review may be applicable to directors, that is: (1) the enhanced business judgment rule of *Unocal*; (2) the quasi auction standard of review of *Revlon*; (3) the entire fairness standard of review of *Kahn v. Lynch*; or (4) the compelling justification standard of review of *Blasius*.

As discussed in chapter 4, the shareholders of a Delaware corporation have the right to vote for directors and on certain extraordinary transactions such as mergers and sales of all or substantially all of the corporation's assets. As discussed in chapter 5, the power of shareholders to elect or replace directors may be constrained, inter alia, by a classified board, the absence of the right of the shareholders to call a special meeting, and the absence of a right of shareholders to act by consent, without a meeting. The proxy advisory firms generally oppose these types of defensive measures, and also generally oppose the unilateral adoption of a poison pill by a board. As discussed previously, a relatively small percentage of the firms in the S&P 500 have these types of defensive measures. On the other hand, proxy advisory firms support majority voting for directors, which for many companies has replaced traditional plurality voting.

§ 1:8.3 Overview of Corporate Governance at the Federal Level

As a result of the enactment of (1) the Sarbanes-Oxley Act (SOX, *infra* Table of References) in 2002, which was in response, inter alia, to the frauds at Enron and WorldCom, and (2) the Dodd-Frank Act, *infra* Table of References, in 2010, which was in response to the financial

crisis, the federal government has intruded more into the states' traditional monopoly on corporate governance. However, the intrusion is not new; it began with the enactment of the Securities Act of 1933, which regulates, inter alia, sales of securities by issuers, and the Securities Exchange Act of 1934, which regulates, inter alia, the proxy and disclosure rules applicable to publicly held firms. (See chapters 6 and 7.) The federalization process continued in 1967 with the enactment of the Williams Act, *infra* Table of References, which, through amendments to the '34 Act, regulates tender offers and open market purchases. (See chapter 8.)

The balance of this section discusses various provisions of SOX and Dodd-Frank that impact corporate governance.

§ 1:8.4 Overview of Corporate Governance Provisions in SOX

As discussed in chapter 6, SOX, *infra* Table of References, added several sections to the '34 Act relating to corporate governance, including provisions:

- Requiring management assessment of internal controls (see section 6:10.2[B][2][b]);
- Requiring disclosure controls (see section 6:10.2[B][2][c]);
- Requiring officer certifications of financial reports, including internal controls and disclosure controls (see section 6:10.2[B][2][e]);
- In essence requiring an independent audit committee that has control of the company's relationship with its outside auditor (see section 6:10.2[C][2]);
- In essence requiring that the audit committee have at least one member who is a "financial expert" (see section 6:10.2[C][3]);
- In essence requiring that the company have a code of ethics (see section 6:10.2[C][1]);
- Requiring that the stock exchanges adopt rules requiring that their listed firms have a majority of independent directors (see section 10A(m)(1) and (3) of the '34 Act and Rule 10A-3 thereunder; and section 303A(1) of the New York Stock Exchange Manual); and
- Requiring that reports of changes in stock ownership by shareholders subject to section 16(a) (relating to officers, directors and 10% shareholders) be filed within two business days of the change (see section 6:12.1).

§ 1:8.5 Overview of Corporate Governance Provisions in Dodd-Frank

As discussed in chapters 6 and 8, Dodd-Frank, *infra* Table of References, added several sections to the '34 Act relating to corporate governance, including the following:

- Provisions giving the shareholders a "say on pay" and golden parachutes (see section 6:10.5[B]);
- A provision authorizing the SEC to adopt rules relating to proxy access (that is, permitting certain shareholders to include their own director nominees on the company's proxy card at the company's expense), which the SEC adopted but then stayed, pending resolution of a legal challenge to the SEC's authority (see section 8:11.3[I]);
- A provision authorizing the closing of the ten-day window in section 13(d), the early warning system (see section 8:4.2);
- A provision authorizing the SEC to issue rules relating to the treatment of security-based swaps for purposes of section 13(d) and section 16(a) (see section 8:4.6[E]);
- A provision requiring the SEC to adopt rules requiring the stock exchanges to require as a listing condition that (1) each member of a firm's compensation committee be independent, and (2) the compensation committee consider the independence of any compensation adviser (see section 10C, '34 Act, added by section 952, Dodd-Frank);
- A provision requiring the SEC to adopt rules requiring the stock exchanges to require as a listing condition that the issuer adopt rules regarding (1) the disclosure of the policy of the issuer on incentive-based compensation that is determined from the issuer's financial information, and (2) in the event of an accounting restatement, the claw-back by the issuer from its current and former employees "who received incentive-based compensation . . . during the 3-year period preceding the date on which the issuer is required to prepare an accounting restatement, based on the erroneous data, in excess of what would have been paid to the executive officer under the accounting restatement" (see section 10D, '34 Act, added by section 954, Dodd-Frank);
- A provision prohibiting (unless instructed by the clients to do so) broker voting of clients' shares "with respect to the election of a member of the board of directors of an issuer, executive compensation, or any other significant matter. . . ." (see section 6(b)(10), '34 Act, added by section 957, Dodd-Frank); and

- A provision establishing a whistleblower program requiring the SEC to pay an award to eligible whistleblowers who voluntarily provide the SEC with original information about a violation of the federal securities laws that leads to the successful enforcement action (see section 21F, '34 Act, added by section 922, Dodd-Frank).

An early version of Dodd-Frank had a provision requiring majority voting for directors, but this provision was not included in the final legislation.

§ 1:9 Guide to References

The literature dealing with mergers and acquisitions is quite extensive, and the Table of References contains citations to many of the most important sources. References are made throughout this work to the sources in the Table of References and to other sources. The purpose of this section is to introduce some of the most important references included in the Table of References.

One of the leading books dealing with negotiated acquisitions is Kling and Nugent, *Negotiated Acquisitions.* Another important, although somewhat dated, book addressing negotiated acquisitions is Freund, *Anatomy of a Merger.* Detailed information dealing with tender offers, takeovers and freezeouts is contained in Lipton and Steinberger, *Takeovers & Freezeouts*; Brown et al., *Takeovers: A Strategic Guide*; and Fleischer and Sussman, *Takeover Defense.* For a discussion of both negotiated acquisitions and takeovers, see Lorne, *Negotiated and Contested Transactions.* For materials reflecting current corporate, securities, and related developments in M&A, see Penn State/NYC Bar, *Fifth Corporate Institute*, and PLI, *M&A*, both of which are updated annually.

The Negotiated Acquisitions Committee of the American Bar Association has published several excellent books on various aspects of mergers and acquisitions, including ABA, *Model Stock Purchase Agreement*; ABA, *Model Asset Purchase Agreement*; and ABA, *Acquisition Review*, focusing on the due diligence process; and ABA, *M&A Process*. See also the ABA's Deal Point studies of M&A: ABA, *2007 Private Equity Buyer/Public Target Deal Point Study*; ABA, *2007 Private Target Deal Point Study*; and ABA, *2008 Strategic Buyer/Public Target, Deal Point Study.* These studies, which are periodically updated, survey various items included in deal documents.

For a general treatment of Delaware corporate law, see Balotti and Finkelstein, *Delaware Corporate Law*; Black, Sparks and Drexler, *Delaware Corporate Law*; Folk on *Delaware Corporate Law*; and Wolfe

and Pittenger, *Delaware Chancery Practice.* For a general treatment of corporate law, see American Bar Association, *Model Business Corporation Act, the MBCA.* For a treatment of the fiduciary duties of directors and the related business judgment rule, see Block et al., *Business Judgment Rule*. See also ALI, *Corporate Governance Project* and Thompson, *ALI Merger and Acquisitions Provisions.*

Three of the leading authorities on federal securities law related to mergers and acquisitions are Loss and Seligman, *Securities Regulation*; Hazen, *Securities Regulation*; and *Securities Law Techniques.*

Two of the leading authorities on taxation of mergers and acquisitions are Ginsburg and Levin, *Mergers and Acquisitions* and Bittker and Eustice, *Corporate Tax.* For a casebook treatment of taxation of mergers and acquisitions, see Thompson, *Corporate Taxation Through the Lens of M&A*. See also Thompson, *U.S. International Tax Planning and Policy.* For materials reflecting current tax developments in M&A, see Penn State/NYC Bar, *Fifth Tax Institute*, and PLI, *Corporate Tax Strategies*, both held annually.

For an exploration of the antitrust aspects of mergers and acquisitions, see Areeda and Turner, *Antitrust*; Hovenkamp, *Antitrust Policy*; Sullivan and Grimes, *Antitrust*; and ABA, *Understanding the Antitrust Aspects of M&A.* For a comprehensive look at antitrust pre-merger notification, see Axinn et al., *Hart-Scott-Rodino* and ABA, *The Antitrust Merger Review Process.*

For an excellent review of banking acquisitions, see Herlihy et al., *Financial Institutions M&A*, published annually.

The literature dealing with the finance and economics of mergers and acquisitions is quite extensive. The following four business-oriented books address these issues: Bruner, *Applied M&A*; Castillo and McAniff, *Investment Banking M&A*; Hunt, *Structuring M&A*; and Weston, *Takeovers.*

General information on M&A is available from many publications, including the *Wall Street Journal*, the *New York Times, The Economist, Corporate Control Alert, M&A Lawyer, The M&A Journal, Mergers and Acquisitions*, and *The Deal.*