# Considerations in Selecting Form of Acquisition

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# Agenda

- Overview of the Acquisition Process
- Forms of Acquisitions
- Issues To Consider In Structuring The Deal
- Considerations in Selecting Form of Acquisition
- Hypothetical Facts
- Key Takeaways

# Overview of the Acquisition Process

## I. Role of Lawyer:

- If representing Buyer, advice on structuring and go/no go decision
- If representing Seller, advice on sale process and deal structure
- Due diligence (buy-side/sell-side)
- Negotiation and documentation
- Getting to closing

# Overview of the Acquisition Process

**II. Typical Acquisition Process**

- Common elements:
  - Preliminary discussions
  - Confidentiality agreement
  - Letter of Intent / term sheet
  - Diligence
  - Negotiation of deal documentation
  - Signing
  - Period between signing and closing (if not simultaneous)
  - Closing
  - Post-closing integration

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# Overview – Basic Forms of Acquisitions

- **Three main types of structures:**
  - Asset acquisition (purchasing the assets of target entity)
  - Stock purchase (purchasing the stock of target entity)
  - Merger (direct or indirect merger with target entity)
- **When looking at acquisition structures, there are several primary considerations that must be balanced**
  - Business & economics (e.g., acquiring less than the whole business, financing and risk allocation, integration and synergistic concerns)
  - Tax & accounting (e.g., tax free transactions, getting a "step up" in basis)
  - Corporate & securities (e.g., needed approvals & applicable thresholds)
  - Contract (e.g., required third party consents)

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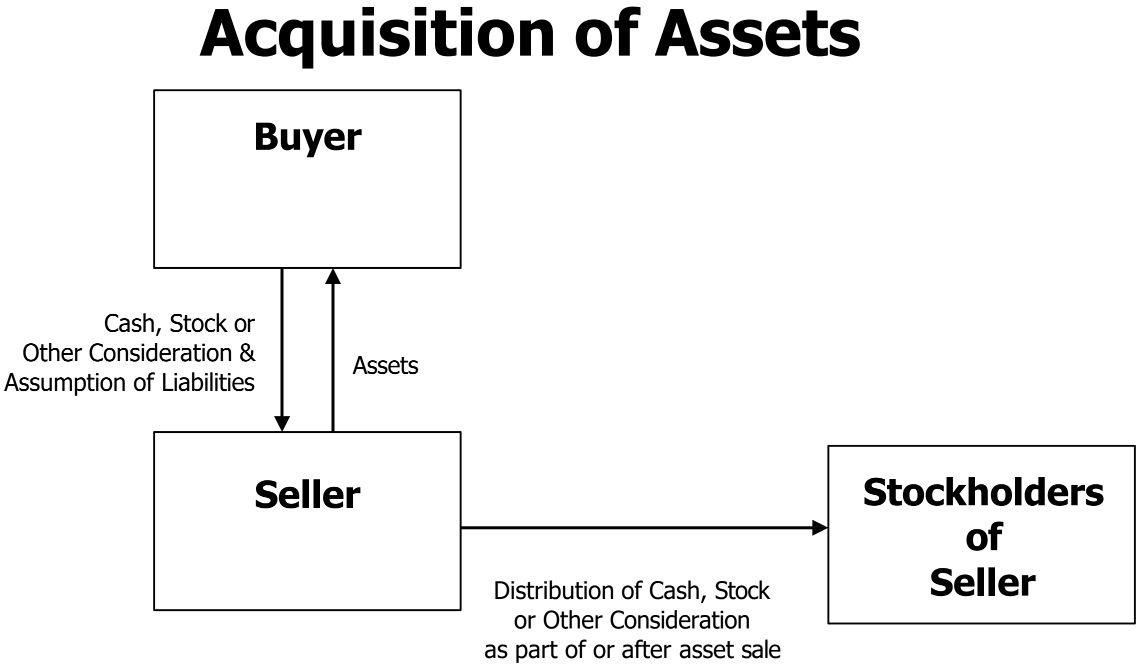
# Basic Forms of Acquisitions

## A. Acquisition of Assets

- Buyer acquires specific assets of Seller for stock of Buyer, cash or other consideration and the assumption of none, some or all of the related liabilities of Seller
- Completed through asset purchase agreement
  - negotiate directly with Seller's management
  - able to specify assumed and excluded assets and liabilities
  - Seller survives acquisition holding:
    - excluded assets
    - excluded liabilities and
    - unless distributed to Seller's creditors or stockholders, the cash, stock or other items paid as consideration

# Basic Forms of Acquisitions – Asset Acquisitions



# Basic Forms of Acquisitions – Asset Acquisitions (cont'd)

**Pros and Cons to Asset Acquisition Structure**

- Buyer
  - Can pick and choose specific assets and liabilities
  - No money wasted on unwanted assets (but may inadvertently fail to purchase an important asset)
  - Lower risk of assuming unknown or undisclosed liabilities – but see Practice Tip below
  - Often better tax treatment than stock acquisitions
  - Separating intermingled businesses (e.g., manual contract and employee transfers, dealing with shared services and IP)
- Seller
  - Left with known/unknown liabilities not assumed
  - If Seller is not a disregarded entity, often better tax treatment when selling stock
  - More complicated (e.g., assigning specific assets, transferring employees, transitional services and shared IP)
  - Lengthier time to closing

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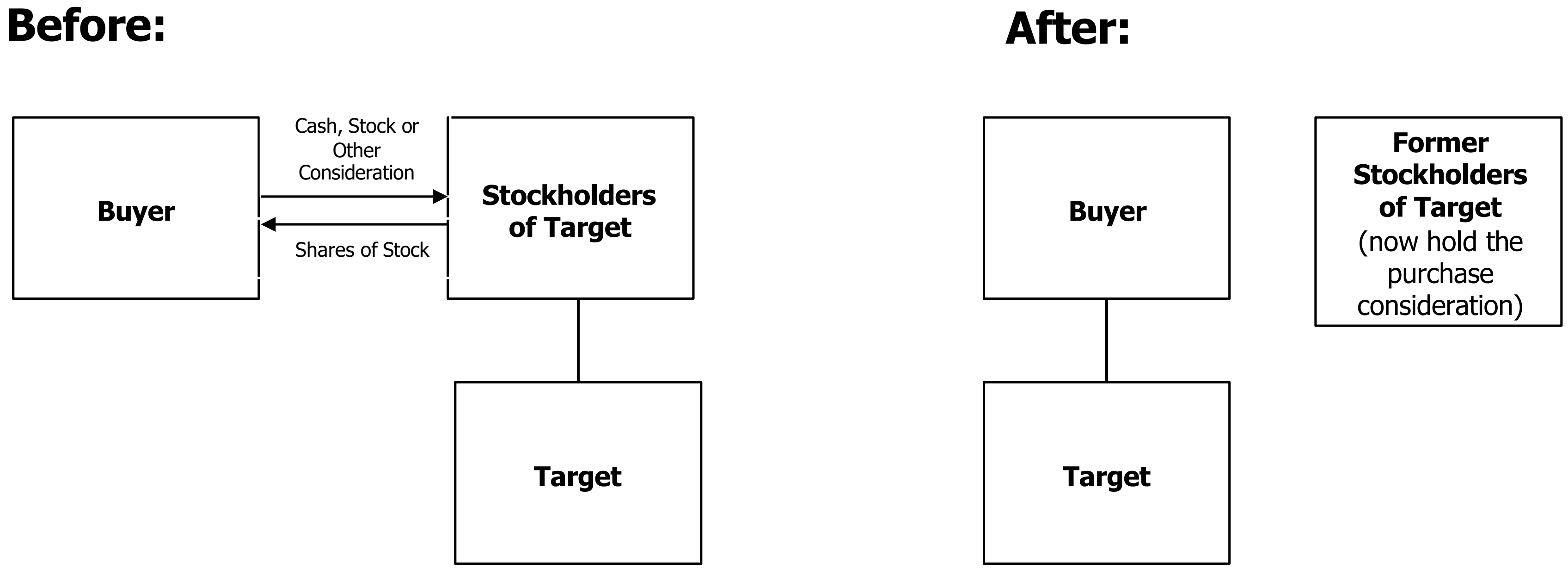
# Basic Forms of Acquisitions – Stock Purchases

**B. Acquisition of Stock**

- Buyer acquires Target's outstanding stock from the stockholders of Seller for stock of Buyer, cash or other consideration
- Completed through stock purchase agreement
  - negotiate directly with Seller's stockholders
  - may acquire less than or 100% of outstanding shares (most strategic Buyers will want 100% ownership)
  - Target continues to hold all of its assets and liabilities both before and after the transaction – now with different stockholder(s)

# Basic Forms of Acquisitions – Stock Purchases (cont'd)

## Acquisition of Stock



# Basic Forms of Acquisitions – Stock Purchases (cont'd)

**Pros and Cons to Stock Acquisition Structure**

- Buyer
  - Cannot pick and choose specific assets and liabilities – will assume all liabilities (known and unknown)
  - Often worse tax treatment than assets acquisitions
- Seller
  - Not left with any contingent liabilities
  - Often better tax treatment than sale of assets
- Not practical if the Target has large number of stockholders, as holders must individually agree to sell and negotiations with multiple shareholders can be costly and time consuming
- Few (if any) statutory requirements for negotiated stock sales

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# Basic Forms of Acquisitions – Mergers

## C. Merger

- Three basic structures, all of which involve statutory mergers in which Target's outstanding stock is converted into the right to receive stock of Buyer, cash or other consideration:

| | |
|---|---|
| **Straight Merger:** | • Target merges into Buyer, with Buyer as surviving corporation<br>• Note: requires approval of Buyer's stockholders (as well as Target's stockholders) |
| **Reverse Triangular Merger:** | • Subsidiary of Buyer merges into Target with Target as surviving corporation |
| **Forward Triangular Merger:** | • Target merges into Subsidiary of Buyer, with Subsidiary as surviving corporation |

- Reverse Triangular Mergers tend to be the most common structure, as it allows the entity to be purchased and survive post-closing as a subsidiary of Buyer (fewer third party consents, no direct hiring of employees, etc., allowing more work to be done post-closing as opposed to prior to closing)

# Basic Forms of Acquisitions – Mergers (cont’d)

- **Three basic forms**
  - Straight merger
  - Forward triangular merger
  - Reverse triangular merger
- **Completed through merger agreement**
  - specific terms of merger negotiated with Target’s management or key stockholders
  - merger occurs by operation of state law for the jurisdiction(s) where the merging entities are organized
  - one of the constituent corporations survives the merger and succeeds to all assets and liabilities of the constituent corporations
- Must comply with the applicable state law merger statutes (e.g., Delaware General Corporation Law (“DGCL”) §§251-271)

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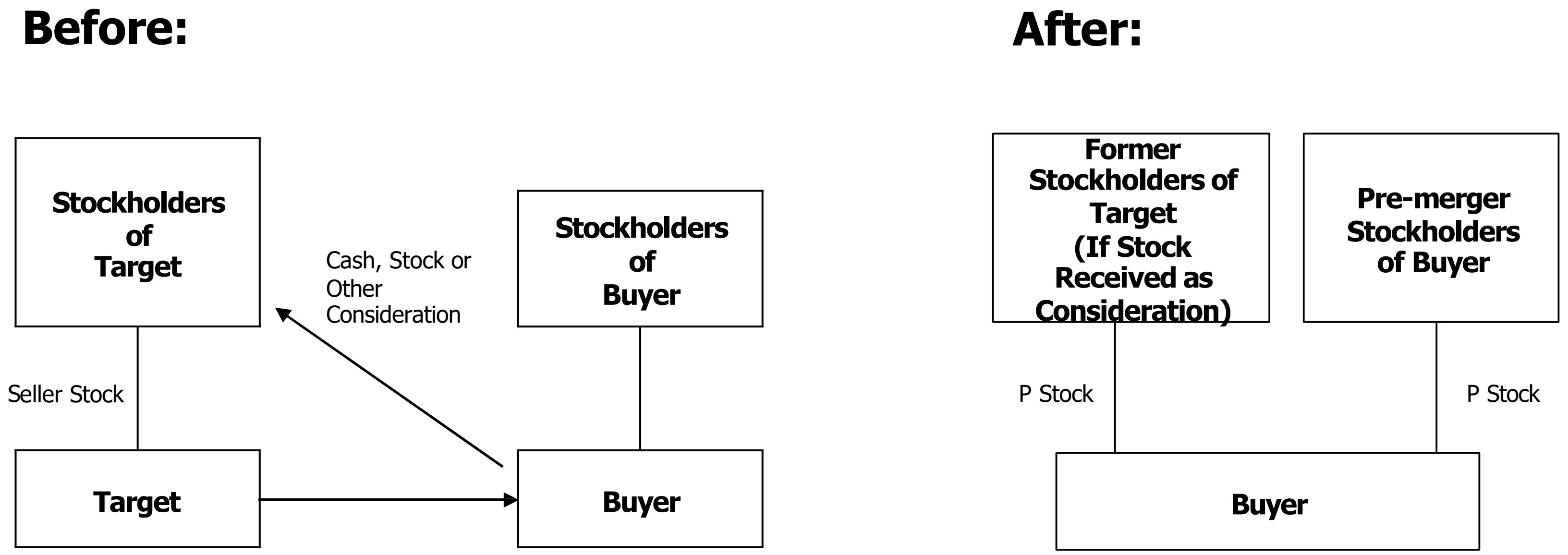
# Basic Forms of Acquisition – Mergers (cont'd)

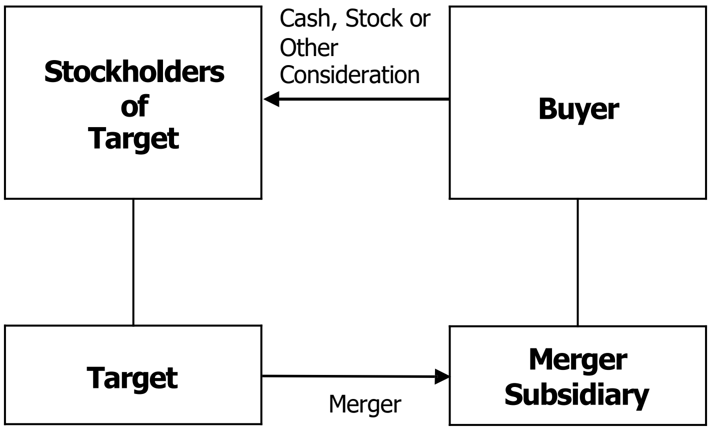
## Straight Merger



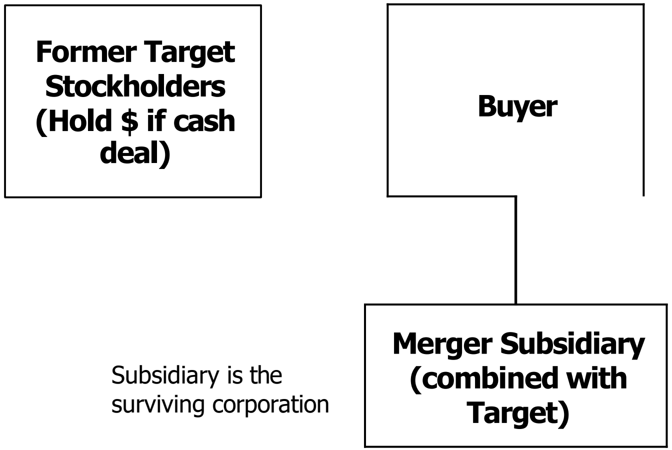
# Basic Forms of Acquisition – Mergers (cont'd)

## Forward Triangular Merger

### Before:



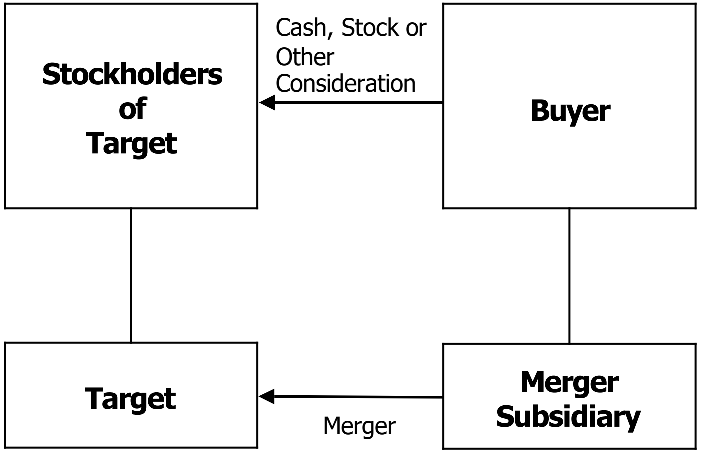

### After:



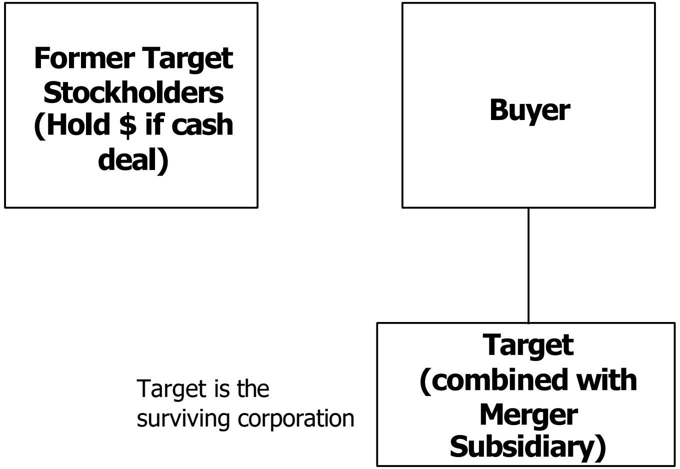
# Basic Forms of Acquisition – Mergers (cont’d)

## Reverse Triangular Merger

### Before:




### After:



# Basic Forms of Acquisition – Mergers (cont'd)

**Pros and Cons to Merger Structure**

- Buyer
  - Cannot pick and choose specific assets and liabilities and assumes all liabilities (known and unknown)
- Seller
  - Not left with any contingent liabilities
- Typically, only majority consent of Target stockholders required – very effective way of completing acquisition of a Company with a large number of stockholders
- Numerous third party consents may be required if Target merged out of existence (alternatively, if a reverse triangular merger, many third party consents may be avoided)
- Target stockholders may need to sign a written consent or voting/support agreement to support the merger
- Appraisal rights providing dissenting shareholders with the right to require a Company to pay them the "fair value" for their shares may apply

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# Additional Structuring Considerations

Generally, the structure of the transaction involves a balancing of competing and sometimes adverse business, tax, corporate law, contract, securities law and accounting considerations.

Leading a client through this analysis is one of the most important roles for an M&A lawyer.

**Basic Questions About Seller**

- Public company/private company
- Private company – number and identity of equityholders
- State of incorporation, and type of entity (e.g., LLC, LLP, S Corp, C Corp, etc.)
- What is Buyer buying?
- Is Seller business in a standalone entity or operated as a division of a larger entity?
- Are there assets/businesses the Buyer does not want to  Acquire

**Tax Treatment**

- Tax treatment for Seller
- Tax treatment for Seller stockholders
- Availability and allocation of tax benefits
- Tax treatment for Buyer if later sells all or part of the business
- Compliance with specific tax requirements (for example, REIT rules)

**Corporate Law**

- Seller shareholder approval
- Buyer shareholder approval
- Appraisal rights

# Additional Structuring Considerations (cont'd)

**Timing/Other**

- Relative leverage (and motivation) of the parties
- Liability profile of the target business
- Ability to obtain indemnity from credit-worthy party
- Financing structures
- Buyout fund structures
- Third party/other consents, regulatory requirements (including Hart-Scott-Rodino antitrust filing)
- State statutes
- Availability of adequate indemnity from seller to cover liability issues that can't be addressed with chosen structure for deal
- Parties' respective timelines

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# Additional Structuring Considerations (cont'd)

**Tax Considerations**

- Taxable or "Tax Free" Transaction - The tax impact on Seller or its stockholders resulting from an acquisition - whether the transaction is taxable or "tax free" (really tax deferred) to Seller - will generally be determined by:
  - the structure of the transaction,
  - the nature and amount of the consideration to be received in the transaction (with consideration being at least 50% stock), and
  - the nature of the entity that is the Seller (i.e. whether the entity is itself a tax payer or a pass-through entity for tax purposes)

- General Rule in Taxable Transaction - Seller is taxed on the gain recognized on the sale of the assets sold. Generally, the gain recognized equals:
  - Cash plus
  - Fair market value of property received plus
  - Liabilities assumed (in an asset sale) less
  - Tax basis in assets sold

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# Additional Structuring Considerations (cont'd)

**Tax Considerations (continued)**

- Try to Avoid "Double Taxation" in Taxable Asset Sale – taxes paid by the entity selling the assets, and then stockholders pay taxes on the net proceeds distributed from sale
- "Tax-Free" Transactions - Seller may seek to structure a transaction so that it is, in whole or in part, "tax free" to its stockholders
- Buyer Tax Preference - A Buyer will generally prefer to acquire assets to maximize its tax benefits but generally must be cognizant of Seller's tax position in structuring a deal and must also be aware of the disadvantages of an asset acquisition (complexity, consents, expense, etc.)

# Additional Structuring Considerations (cont'd)

- Corporate Law Considerations
  - Mergers - statutory; driven by state law; statutes will dictate approvals, filings, effectiveness of merger and appraisal rights
  - Corporate Approval Matters, which can also affect timing
    - Board of Directors Approvals
    - Stockholder Approvals
    - Third Party Approvals
- Third Party Consents
  - Deal structure can often dictate whether or not third party consents are required for the deal. An example would be a key lease or IP license that prohibits assignment but has no restrictions on a change of ownership

# Additional Structuring Considerations (cont'd)

**Securities Law Considerations**

Whenever stock is being transferred in a transaction, securities law issues need to be considered

- Acquisitions of private companies - Buyer must find exemption from federal securities law requirements to register its stock in an acquisition
- State securities laws - Consider state securities law matters; may have filings or approvals at the state level depending on structure and the nature of the parties receiving stock in the acquisition; may have pre- or post-transaction filings; consult local counsel if Seller or Seller's stockholders reside in different states