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PART I. THE BASICS OF A CORPORATE ACQUISITION

CHAPTER 1 THE PRIMARY TYPES OF CORPORATE ACQUISITIONS

Corporations are artificial legal entities. They must be created and empowered by legislative authority. In the United States, unlike most other countries of the world, individual states charter corporations at the request of groups of individuals, *incorporators*. All states now use a registration system; that is, if the papers filed by incorporators meet minimal, objective administrative standards, a state official must give official recognition to the new corporate entity.

The state corporate codes provide the fundamental authorization for corporations to enter into major corporate acquisitions. Moreover, the state codes specify the internal procedures required for corporations participating in acquisitions. The provisions on acquisitions of our 50 state corporate codes give corporate acquisitions in the United States their basic structure and, therefore, their basic legal nomenclature. The statutory definitions depend more on the *procedure*

constituent parties use to effect the transaction than the end position of the parties.

Since the beginning of this century the tiny state of Delaware has been the most popular jurisdiction of incorporation for large, publicly-traded multistate corporations. Almost 60 percent of our 500 largest corporations and almost one-half of the corporations listed on the New York Stock Exchange are Delaware corporations. Relative to most other states, Delaware's basic corporate code, entitled the "Delaware General Corporation Law," gives more leeway to corporate managers in their operation of the firm's business.

Perhaps the most important illustration of Delaware's enhanced flexibility is in its provisions on mergers and acquisitions. Indeed the differences are so pronounced in the acquisition sections that one often finds large firms changing their place of incorporation to Delaware on the eve of a major acquisition to take advantage of the Delaware provisions. Sections of the Delaware corporate code will be referenced as "DGCL §."

The structure of the DGCL is typical of the structure of most state corporate codes. The authority and procedure for effecting a *statutory merger* is outlined in § 251, and the legal effect of a merger is detailed in §§ 259 to 261. A special *short-form* merger procedure for some parent-subsidary mergers is contained in § 253. The code covers mergers between domestic and foreign corpora-

tions (corporations incorporated in other states) in § 252 and mergers between corporations and limited liability companies (an artificial legal entity registered under a separate enabling act) in § 264.

There is also an abbreviated procedure for cash mergers in § 251(f). The procedure for an *asset sale* is contained in § 271. The appraisal rights of dissenting shareholders are outlined in § 262. Delaware regulates single-firm reorganizations of capital structure in § 242, which specifies the requirements for amending a corporation's certificate of incorporation. The only provision specific to *stock acquisitions* is § 203 that limits hostile tender offers.

Delaware also has developed a sophisticated body of precedent on corporate law issues, because of the expertise of the judges in a limited jurisdiction trial court, the Delaware Court of Chancery, and of the justices in the Delaware Supreme Court, who hear appeals from the Chancery Court. This body of case law precedent has proven to be particularly important in acquisitions that often cause disgruntled shareholders to take their grievances to court. The Delaware case law controls Delaware corporations and is often viewed as significant precedent by the courts of other states dealing with their domestically incorporated firms. As a consequence, this Nutshell will often feature and discuss Delaware court cases.

At the other end of the spectrum is California's corporate code, which features a heavier regulatory hand. Its acquisition provisions give shareholders of constituent corporations their strongest set of voting and appraisal rights, for example. As a consequence, very few of our large multistate corporations are incorporated in California. California does, however, usually have one of the highest numbers of annual incorporations of all the states because of the many new small businesses formed in the state. Most states fall somewhere between the Delaware and California models.

The Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association, in partnership with the American Law Institute, exerts a very significant influence on the content of many state corporate codes. The committee has developed and periodically revises a Model Business Corporation Act (hereafter cited as the MBCA). Over 35 states have used one of the versions of the MBCA as a basis for their local codes, and states scrutinize each new revision of sections in the MBCA with an eye to adopting the most modern provisions. The ABA has made a proposed major revision to the Model Act in 1998 and 1999 relevant to mergers and acquisitions.

This Nutshell will feature the provisions of the DGCL and the MBCA on mergers and acquisitions. Brief mention is also made of the California provisions.

§ 1. The Statutory Merger or Consolidation

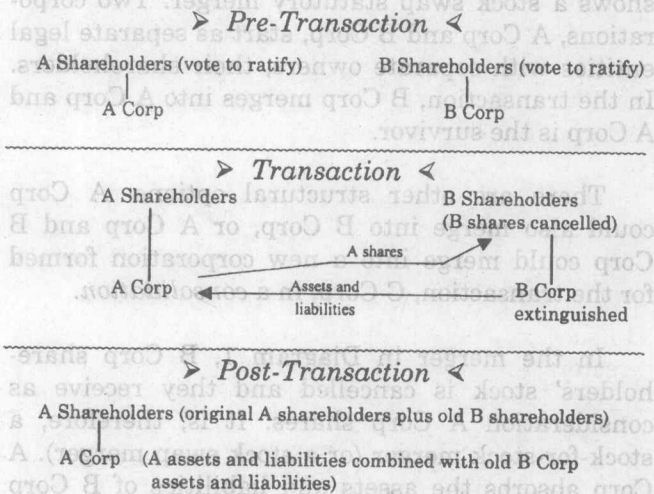
Stock Swap Statutory Merger. Diagram 1 shows a stock swap statutory merger. Two corporations, A Corp and B Corp, start as separate legal entities with separate owners, their shareholders. In the transaction, B Corp merges into A Corp and A Corp is the survivor.

There are other structural options. A Corp could also merge into B Corp, or A Corp and B Corp could merge into a new corporation formed for the transaction, C Corp, in a *consolidation*.

In the merger in Diagram 1, B Corp shareholders' stock is cancelled and they receive as consideration A Corp shares. It is, therefore, a stock-for-stock merger (or a stock swap merger). A Corp absorbs the assets and liabilities of B Corp "as a matter of law." We will investigate further what this means in the chapter on successor liability.

After the merger closes, only A Corp survives; B Corp is extinguished. The shareholders of A Corp continue to hold their stock as before and the shareholders of old B Corp now hold newly-issued additional A Corp stock; the ownership interests of A Corp and B Corp are pooled in the survivor. A Corp now has added the assets and liabilities of old B Corp to A Corp's original assets and liabilities; the assets and liabilities of both constituent corporations are pooled.

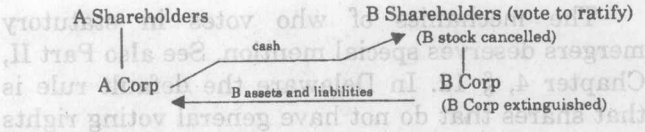
Diagram 1.
The Plain-Vanilla Statutory Merger:
Stock for Stock*



* This is a tax-free merger (an A reorganization).

Cash-out Statutory Mergers. In a *cash-out transaction*, the purchasing firm does not want the shareholders of the selling firm to end up holding voting common stock in the purchasing firm. The purchasing firm wants to pay cash for the selling firm or, if cash is not available, to pay the selling firm shareholders in non-voting investments in the purchasing firm—debentures (debt) or non-voting preferred or common stock (equity). For a cash-out statutory merger, start with Diagram 1 and replace the A Corp shares going to the B Corp shareholders with cash. See Diagram 2.

Diagram 2. Cash-Out Merger*



* This is a taxable transaction.

Required Procedure for a Statutory Merger. If both A Corp and B Corp are Delaware corporations, DGCL § 251 controls the acquisition. Section 251(a) authorizes both firms to engage in the transaction and § 251(b) requires that the board of directors of both firms pass a resolution approving an *Agreement of Merger*. The agreement states the terms and conditions of the merger and whether the certification of incorporation of the survivor is amended. Both constituent corporations, A Corp and B Corp, then must submit the agreement to a shareholder vote under § 251(c). A majority of all the *outstanding* shares entitled to vote must ratify the agreement. (MBCA § 11.04(e) reduces the voting requirement to a majority of those present at the shareholders' meeting if a quorum exists.) The shareholders of neither constituent corporation can initiate the acquisition vote nor can they amend the agreement; it is an up or down ratifying vote. After the vote, the agreement (or a summary of the agreement entitled a "Certificate of Merger") is filed with the Delaware Secretary of State to become effective on a date specified in the near future. On that date representatives of the