

ASPEN CASEBOOK SERIES

THOMPSON

**MERGERS AND
ACQUISITIONS**
Law and Finance

*Second
Edition*



Wolters Kluwer

Law & Business

ASPEN CASEBOOK SERIES

***MERGERS AND
ACQUISITIONS:
LAW AND FINANCE***

ROBERT B. THOMPSON

Peter P. Weidenbruch Jr. Professor of Business Law
Georgetown University Law Center

Second Edition



Wolters Kluwer
Law & Business

Copyright © 2014 CCH Incorporated.

Published by Wolters Kluwer Law & Business in New York.

Wolters Kluwer Law & Business serves customers worldwide with CCH, Aspen Publishers, and Kluwer Law International products. (www.wolterskluwerlb.com)

No part of this publication may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopy, recording, or utilized by any information storage or retrieval system, without written permission from the publisher. For information about permissions or to request permissions online, visit us at www.wolterskluwerlb.com, or a written request may be faxed to our permissions department at 212-771-0803.

To contact Customer Service, e-mail customer.service@wolterskluwer.com, call 1-800-234-1660, fax 1-800-901-9075, or mail correspondence to:

Wolters Kluwer Law & Business
Attn: Order Department
PO Box 990
Frederick, MD 21705

Printed in the United States of America.

1 2 3 4 5 6 7 8 9 0

ISBN 978-1-4548-3765-7 (Casebound)

ISBN 978-1-4548-4838-7 (Loose-leaf)

Library of Congress Cataloging-in-Publication Data

Thompson, Robert B., 1949- author.

Mergers and acquisitions : law and finance / Robert B. Thompson, Peter P. Weidenbruch, Jr. Professor of Business Law, Georgetown University Law Center. — Second edition.
p. cm.

Includes bibliographical references and index.

ISBN 978-1-4548-3765-7 (alk. paper)

1. Consolidation and merger of corporations — Law and legislation — United States. I. Title. KF1477.T478 2014 346.73'06626 — dc23

2014004642



**SUSTAINABLE
FORESTRY
INITIATIVE**

Certified Sourcing

www.sfiprogram.org

SFI-01234

SFI label applies to the text stock

*MERGERS AND
ACQUISITIONS:
LAW AND FINANCE*

EDITORIAL ADVISORS

Vicki Been

Boxer Family Professor of Law
New York University School of Law

Erwin Chemerinsky

Dean and Distinguished Professor of Law
University of California, Irvine, School of Law

Richard A. Epstein

Laurence A. Tisch Professor of Law
New York University School of Law
Peter and Kirsten Bedford Senior Fellow
The Hoover Institution
Senior Lecturer in Law
The University of Chicago

Ronald J. Gilson

Charles J. Meyers Professor of Law and Business
Stanford University
Marc and Eva Stern Professor of Law and Business
Columbia Law School

James E. Krier

Earl Warren DeLano Professor of Law
The University of Michigan Law School

Richard K. Neumann, Jr.

Professor of Law
Maurice A. Deane School of Law at Hofstra University

Robert H. Sitkoff

John L. Gray Professor of Law
Harvard Law School

David Alan Sklansky

Yosef Osheawich Professor of Law
University of California at Berkeley School of Law

About Wolters Kluwer Law & Business

Wolters Kluwer Law & Business is a leading global provider of intelligent information and digital solutions for legal and business professionals in key specialty areas, and respected educational resources for professors and law students. Wolters Kluwer Law & Business connects legal and business professionals as well as those in the education market with timely, specialized authoritative content and information-enabled solutions to support success through productivity, accuracy and mobility.

Serving customers worldwide, Wolters Kluwer Law & Business products include those under the Aspen Publishers, CCH, Kluwer Law International, Loislaw, ftwilliam.com and MediRegs family of products.

CCH products have been a trusted resource since 1913, and are highly regarded resources for legal, securities, antitrust and trade regulation, government contracting, banking, pension, payroll, employment and labor, and healthcare reimbursement and compliance professionals.

Aspen Publishers products provide essential information to attorneys, business professionals and law students. Written by preeminent authorities, the product line offers analytical and practical information in a range of specialty practice areas from securities law and intellectual property to mergers and acquisitions and pension/benefits. Aspen's trusted legal education resources provide professors and students with high-quality, up-to-date and effective resources for successful instruction and study in all areas of the law.

Kluwer Law International products provide the global business community with reliable international legal information in English. Legal practitioners, corporate counsel and business executives around the world rely on Kluwer Law journals, looseleafs, books, and electronic products for comprehensive information in many areas of international legal practice.

Loislaw is a comprehensive online legal research product providing legal content to law firm practitioners of various specializations. Loislaw provides attorneys with the ability to quickly and efficiently find the necessary legal information they need, when and where they need it, by facilitating access to primary law as well as state-specific law, records, forms and treatises.

ftwilliam.com offers employee benefits professionals the highest quality plan documents (retirement, welfare and non-qualified) and government forms (5500/PBGC, 1099 and IRS) software at highly competitive prices.

MediRegs products provide integrated health care compliance content and software solutions for professionals in healthcare, higher education and life sciences, including professionals in accounting, law and consulting.

Wolters Kluwer Law & Business, a division of Wolters Kluwer, is headquartered in New York. Wolters Kluwer is a market-leading global information services company focused on professionals.

To my family—Dottie, Blake, Beth, Mira, Hunter, Adrienne, Lucy,
Isaiah, and Micah, who have made this journey enjoyable

PREFACE

This book focuses on mergers and more particularly on how lawyers create value in a transactional setting. As befitting a course that typically comes late in one's law school education, this material moves the focus from case analysis to understanding the deal. We study not only the legal rules but also the economic and financial principles that shape the strategy of lawyers in this area and the clients they advise. Experience has shown that lawyers with knowledge of these adjacent fields create greater value in transactions.

Examples of this broadened focus include these:

- The first item that follows each case is most often a note entitled "The Deal." This structure asks you to understand who the parties were, but also what they were trying to accomplish, where the value would come from in the deal, and the choices available to planners because of those sources of value. In the *Revlon* case, for example, it makes a difference that what had been a grocery store company (albeit one with a raider at its helm) was making a hostile run at the sophisticated cosmetic giant Revlon.
- There is a separate chapter on the "poison pill" that both illustrates this entrepreneurial lawyerly innovation and provides a template for understanding defensive tactics that are a key part of the mergers and acquisitions landscape. The legal case is placed within the context of the specific problem that the lawyers needed to solve—to create a barrier against one of the few things that shareholders are permitted to do under corporate law that could undercut directors' control of the corporation—and shows how the poison pill did that in a creative and unusual way. Later parts of the chapter trace how the provision continued to evolve and how the strategies and techniques morphed with each new deal, an evolutionary pattern that prospective lawyers will want to understand throughout the study of mergers and acquisitions.
- The book begins by asking what planners are trying to accomplish in an acquisition, in financial terms of how new value is created, and in legal terms of the law's contribution to value added through use of legal forms and entities.

- Valuation is crucial to understanding deals and this book contains a rich but accessible introduction of the core principles that underlie how courts and finance experts value companies. Specific merger cases in the appraisal setting are then used to provide a way to work through the principles just introduced.
- Insider trading and the wonderful cases that populate the area that arise most often in a takeover setting are put within a broader discussion of the economic value of information.

Students come to a mergers course with a variety of prior experiences in corporate law. The pedagogical challenge is to get everyone to the same foundational level as quickly as possible. Thus, in Chapter 5, core principles of corporate governance are presented in a way that both jogs the memory of those who have dealt with these legal issues in other courses and sets the stage for a richer exploration of these principles in the context of mergers and acquisitions. My approach is informed by a decade of co-teaching mergers to a class made up of both law and business students that provided an ongoing laboratory in working through the most effective way to teach finance to law students and law to business students without simultaneously having the other half of the class tune out the discussion. I am grateful to my law and management students at Vanderbilt who regularly improved the presentation of ideas covered in this book and later classes of students at Georgetown. I am particularly grateful to my co-teacher in those classes, Ron Masulis, an energetic and distinguished finance professor, whose curiosity is broad, whose questions are precise and right-on, and whose willingness to make things better is tireless. In those classes and elsewhere, I have also benefited from distinguished practitioners in both finance and law who have been willing to share their insights, including particularly, Delaware jurist Leo Strine, New York practitioner David Katz, and Nashville's Jim Cheek, who regularly co-taught a follow-on course for students interested in mergers.

I gratefully acknowledge Wachtell, Lipton, Rosen & Katz for granting permission to reprint The Wachtell Lipton Share Purchase Rights Plan.

I welcome comments, questions, and suggestions at thompson@law.georgetown.edu.

Robert B. Thompson

March 2014
Washington, D.C.

*MERGERS AND
ACQUISITIONS:
LAW AND FINANCE*

SUMMARY OF CONTENTS

<i>Contents</i>	<i>xi</i>
<i>Preface</i>	<i>xix</i>
Chapter 1. WHY MERGERS HAPPEN: MACROECONOMIC TRENDS	1
Chapter 2. FINANCIAL AND ECONOMIC INCENTIVES THAT SHAPE MERGERS	11
Chapter 3. LEGAL SHAPING OF DEALS	23
Chapter 4. DEAL STRATEGY: THE BIDDER'S APPROACH	65
Chapter 5. THE TARGET'S APPROACH: REMAINING INDEPENDENT OR GETTING THE BEST DEAL FROM THE FIRST OR ANOTHER BIDDER	95
Chapter 6. JUDICIAL REVIEW OF DEFENSIVE TACTICS	141
Chapter 7. POISON PILLS: A CASE STUDY OF DEFENSIVE TACTICS AND JUDICIAL REVIEW	225
Chapter 8. IS A DEFENSE AFFECTING VOTING DIFFERENT?	281
Chapter 9. FINANCE FOUNDATION FOR VALUATION	319
Chapter 10. CASH-OUT MERGERS	331
Chapter 11. SALE OF CONTROL FOR A PREMIUM	423
Chapter 12. DISCLOSURE AND LIMITS ON THE USE OF INFORMATION	455
Chapter 13. FINANCIAL REORGANIZATIONS: HIGHLY LEVERAGED TRANSACTIONS, GOING PRIVATE, ASSET RESTRUCTURING	491
Chapter 14. ACTIVIST SHAREHOLDERS	535
Chapter 15. INTERNATIONAL TRANSACTIONS	563
 <i>Appendix A: Delaware General Corporation Law</i>	 573
<i>Appendix B: Federal Statutes & Regulations</i>	605
<i>Table of Cases</i>	633
<i>Index</i>	637

CONTENTS

Preface

xix

1. WHY MERGERS HAPPEN: MACROECONOMIC TRENDS

1

- A. Merger Waves 1
- B. Macroeconomic Factors That Contributed to Merger Waves 3
- C. Who Captures the Benefits of Acquisitions? 5
 - 1. Target Shareholders and Acquirer Managers 5
 - 2. Impact on Other Stakeholders 8

2. FINANCIAL AND ECONOMIC INCENTIVES THAT SHAPE MERGERS

11

- A. Synergies 11
- B. Change of Control Benefits and Changes in Financial Aspects of the Business 12
- C. Summary of Gains from Acquisitions 13
- D. Costs of Acquisitions; Why Acquisitions Fail 14
 - 1. Costs Incurred in Acquisitions 15
 - 2. How Acquisitions Destroy Wealth 15
- E. Acquisition Financing Decisions 16
 - 1. How Much of the Target Does the Bidder Wish to Acquire? 17
 - 2. Currency Choices 17
 - a. Stock or Cash 17
 - b. Economic Effects of Financing Choices 18
 - c. Impact on the Acquirer's Capital Structure and Costs of Capital 18
 - d. Ownership Structure 19
 - e. Tax Liability 19
 - f. Risks Bearing Under Alternative Currencies 20

Problems 21

xi

3. LEGAL SHAPING OF DEALS	23
A. The Law's Distinctive Roles	23
B. Mergers and Other Acquisitions as a Decision Governed by Law	24
1. Corporate Law Reduced to Three (Overly Simplified) Rules	24
2. The Merger Form as a Template for Understanding Legal Regulation of Acquisition Transactions	26
3. Alternative Legal Structures for Acquisition That Permit Planners to Avoid One or More of the Requirements of the Merger Template	28
C. Judicial Limits on Private Planning to Avoid Particular Merger Effects: De Facto Merger	34
<i>Hariton v. Arco Electronics, Inc.</i>	34
<i>Farris v. Glen Alden Corp.</i>	36
<i>Terry v. Penn Central Corp.</i>	42
Notes and Questions	47
D. Federal Law Affecting Deals	51
1. Securities Law	51
a. "Disclosure, Again Disclosure, and Still More Disclosure"	51
<i>Prudent Real Estate Trust v. Johncamp Realty, Inc.</i>	54
Notes and Questions	58
b. Substantive Regulations from Securities Law, Particularly Tender Offers	60
c. Avoiding Securities Regulation	60
2. Tax	61
3. Antitrust	62
4. National Security	64
4. DEAL STRATEGY: THE BIDDER'S APPROACH	65
A. Beginning the Deal Dance: Who to Approach?	65
B. Getting to a Definitive Agreement	67
1. Deal Terms: Financial, Legal, and Social	67
2. Due Diligence	68
3. Negotiating the Acquisition Agreement	69
<i>In re IBP, Inc. Shareholders Litigation</i>	70
Notes and Questions	79
<i>Martin Marietta Materials, Inc. v. Vulcan Materials Co.</i>	80
Notes and Questions	92

5. THE TARGET'S APPROACH: REMAINING INDEPENDENT OR GETTING THE BEST DEAL FROM THE FIRST OR ANOTHER BIDDER 95

A.	The Legal and Economic Framework	95
1.	Financial Defenses	96
2.	Legal Defenses	97
B.	Fiduciary Duties and Legal Challenges to Board Action	98
	<i>Smith v. Van Gorkom</i>	98
	Notes and Questions	117
	<i>Gantler v. Stephens</i>	119
	Notes and Questions	128
	<i>Lyondell Chemical Co. v. Ryan</i>	131
	Notes and Questions	139

6. JUDICIAL REVIEW OF DEFENSIVE TACTICS 141

A.	The Corporate Law Template for Considering Takeover Defenses	141
	<i>Unocal Corp. v. Mesa Petroleum Co.</i>	143
	Notes and Questions	150
	<i>Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.</i>	152
	Notes and Questions	159
B.	Applying <i>Unocal</i> and <i>Revlon</i> —The Two Paramounts	160
	<i>Paramount Communications, Inc. v. Time Inc.</i>	160
	Notes and Questions	170
	<i>Paramount Communications, Inc. v. QVC Network Inc.</i>	172
	Notes and Questions	188
C.	The Evolution of <i>Unocal</i> ; Deal Protection Devices	189
	<i>Louisiana Municipal Police Employees' Retirement System v. Crawford</i>	189
	<i>Omnicare, Inc. v. NCS Healthcare, Inc.</i>	191
	Notes and Questions	206
D.	State Anti-Takeover Statutes as Defensive Mechanisms	210
	<i>Amanda Acquisition Corp. v. Universal Foods Corp.</i>	213
	Notes and Questions	222

7. POISON PILLS: A CASE STUDY OF DEFENSIVE TACTICS AND JUDICIAL REVIEW 225

A.	The Challenge Facing the Drafters of the Poison Pill	225
	Wachtell, Lipton, Rosen & Katz, The Share Purchase Rights Plan	226
	Notes and Questions	232

B.	Judicial Review of Director Action to Implement or Continue a Poison Pill	234
	<i>Moran v. Household International, Inc.</i>	234
	Notes and Questions	242
	<i>City Capital Associates Ltd. Partnership v. Interco Inc.</i>	243
	Notes and Questions	257
	<i>Air Products and Chemicals, Inc. v. Airgas, Inc.</i>	259
	Notes and Questions	263
C.	Evolution in the Poison Pill and Judicial Responses	264
	<i>Carmody v. Toll Brothers, Inc.</i>	265
	<i>Quickturn Design Systems, Inc. v. Shapiro</i>	271
	Notes and Questions	275

8. IS A DEFENSE AFFECTING VOTING DIFFERENT? 281

<i>Schnell v. Chris-Craft Industries, Inc.</i>	282
<i>Blasius Industries, Inc. v. Atlas Corp.</i>	286
Notes and Questions	295
<i>Unitrin, Inc. v. American General Corp.</i>	295
Notes and Questions	306
<i>MM Companies, Inc. v. Liquid Audio, Inc.</i>	308
Notes and Questions	317

9. FINANCE FOUNDATION FOR VALUATION 319

A.	Introduction	319
B.	A Primer on Financial Theory Underlying the Discounted Cash Flow Method of Valuation	320
	Problem	323
C.	The Mechanics of a Discounted Cash Flow Analysis	323
1.	Forecasting Free Cash Flow	324
a.	The Explicit Forecast Period (i.e., The First Five Years)	324
b.	Terminal Value	326
2.	Picking an Appropriate Discount Rate	326
3.	Adjustments	327
4.	Forecasting Change in Free Cash Flow from the Merger	327
D.	Deal Comparables, Company Comparables, and Other Measures	327

10. CASH-OUT MERGERS 331

A.	Majority Power, Minority Rights to Exit Via Appraisal or Gain Judicial Review for Breach of Fiduciary Duty	331
	<i>Weinberger v. UOP, Inc.</i>	331

	Notes and Questions	345
	<i>Cede & Co. v. Technicolor, Inc.</i>	349
	Notes and Questions	360
B.	Valuation Techniques	362
	<i>In re Emerging Communications, Inc. Shareholders Litigation</i>	362
	Notes and Questions	385
C.	Short-Form Mergers	386
	<i>Glassman v. Unocal Exploration Corp.</i>	386
	Notes and Questions	391
	<i>Berger v. Pubco Corp.</i>	392
D.	Planning to Minimize Judicial Review	400
	<i>In re Cox Communications, Inc. Shareholders Litigation</i>	400
	Notes and Questions	416

11. SALE OF CONTROL FOR A PREMIUM 423

	<i>Perlman v. Feldmann</i>	424
	Notes and Questions	429
	<i>Mendel v. Carroll</i>	431
	Notes and Questions	443
	<i>In re Synthes, Inc. Shareholder Litigation</i>	443
	Notes and Questions	453

12. DISCLOSURE AND LIMITS ON THE USE OF INFORMATION 455

A.	Risk Arbitrage, Mandatory Disclosure, and the Search for Information	455
B.	Law's Effect on Information	459
1.	Mandatory Disclosure from Federal Law	459
2.	Mandatory Disclosure's Impact on Information About Merger Transactions and the Additional Effect of Antifraud Prohibitions	461
a.	When Will Merger Information Have to Be Disclosed?	461
b.	Remedies for Failure to Comply with Mandatory Disclosure or Antifraud Provisions Relating to Mergers	464
3.	Disclosure Duties Arising from State Law Fiduciary Duty	464
C.	Law's Limits on the Use of Inside Information	466
1.	Classic Insiders	466
	<i>Chiarella v. United States</i>	466
2.	Tippee Liability and Constructive Insiders	470
	<i>Dirks v. Securities and Exchange Commission</i>	470
	Note	478

3. Misappropriation and Rule 14e-3 Liability	479
<i>United States v. O'Hagan</i>	479
Notes and Questions	487
4. Assembling the Bases for Insider Trading Liability	488
13. FINANCIAL REORGANIZATIONS: HIGHLY LEVERAGED TRANSACTIONS, GOING PRIVATE, ASSET RESTRUCTURING	491
A. Leveraged Buyouts, Going Private, and Other Transactions Making Use of Leverage	491
1. Economic Factors Used to Create Wealth in LBOs	492
2. It's Not for Everyone: The Ideal Candidate for an LBO; Empirical Evidence on Post-Transaction Performance	494
3. Exit	495
4. Law Shaping the LBO Deal	496
<i>Metropolitan Life Insurance Co. v. RJR Nabisco, Inc.</i>	498
5. HCA's LBO as a Case Study	511
6. <i>Topps</i> as a Case Study of the Overlap of Federal Disclosure and State Intermediate Scrutiny	517
<i>In re The Topps Co. Shareholders Litigation</i>	517
Notes and Questions	526
B. Leveraged Recapitalizations	528
C. Asset Restructuring	531
1. Divestitures	531
2. Carve-Outs	532
3. Spinoff	533
14. ACTIVIST SHAREHOLDERS	535
A. Who Are Activist Shareholders?	535
B. Patterns of Engagement	536
<i>CSX Corp. v. Children's Inv. Fund Management (UK) LLP</i>	540
Notes and Questions	561
15. INTERNATIONAL TRANSACTIONS	563
A. Determining Which Law	564
B. More Expansive Roles for Shareholders in Friendly Deals	565
C. Roles for Groups Other than Shareholders	566
D. Different Approaches to Ability of Management to Oppose Deals Favored by Shareholders	567
E. Different Rules in Deals by a Controlling Shareholder	567