International Mergers & Acquisitions Law

A Country-by-Country Look at M&A Regulations and Best Practices in Major Markets around the Globe
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Introduction

The most important laws governing mergers and acquisitions in the United States are the corporate statutes for the jurisdictions in which the companies are located, U.S. securities laws and regulations, the Hart-Scott-Rodino Act and other antitrust laws, state anti-takeover laws, U.S. and state tax laws, and specific regulatory laws applicable to particular industries.

Key Participants

The key participants in merger and acquisition transactions are the management team and board of directors of each participating company, and its investment bankers, legal team, accountants and other financial experts.

Management Team & Directors

For each company, its chief executive officer, president, vice-president of business development, general counsel, chief financial officer, possibly one or more directors or a committee of directors and, if a division is involved, the senior executives of that business unit are often involved in the transaction.

The management team of a company being acquired often has various motives, ranging from obtaining necessary financing to enable the business to proceed forward, addressing competitive issues and the company’s ability to compete effectively in the marketplace, providing continuing employment to the company’s employees, and realizing on or providing for shareholder liquidity and value.

From the point of view of an acquiring company, the management team and directors are generally looking to grow the business in ways that they cannot do through internal growth, whether to obtain new products, to enter into new markets, to diversify, to spread the overhead over a larger base, or otherwise. They are also motivated in doing a transaction that is accretive to shareholder value.
**Investment Bankers**

Investment bankers are generally compensated as a result of the success of the transaction and they are highly motivated to seek to maximize value and close the deal. They work with the target company to understand its financial condition and value, position in the industry and other factors that would make the company attractive to an acquirer in order to present the company in the most favorable light, and identify and obtain the most favorable economic terms. They also use their expertise in industries and relationships with buyers to bring the appropriate buyers to the target. When representing the acquiring company, they help determine the value of the target company, and help to structure and negotiate the deal terms. They may also help to identify or arrange for any financing required for the transaction. They may also provide advice to the board of the company they represent regarding the fairness of the terms of the transaction, sometimes issuing a fairness opinion as part of the transaction.

**Lawyers**

The lawyers involved for each company generally include a lead deal lawyer and a team of corporate attorneys working with the lead lawyer, as well as specialists, as needed, in the following areas: securities, tax, employment/ERISA/pension; environmental; real property; specific business specialty expertise (such as healthcare, Federal Communication Commission matters, bankruptcy, government contracting, intellectual property export control, etc.); antitrust/Hart-Scott-Rodino; and international and antitrust regulatory approval.

The legal teams for both acquiring and acquired companies work closely with their respective management teams and their investment bankers to negotiate and document the transaction. Their responsibility is to help structure the deal and identify and resolve the legal and business issues that arise, draft and negotiate definitive documents and help find solutions and overcome obstacles to a closing. Counsel to the target or acquired company helps coordinate obtaining shareholder and regulatory approval, and may prepare proxy statements for communications with shareholders. Counsel for the acquirer may prepare registration statements (if securities are part of
the consideration), as well as assist the acquiring entity in any debt or equity transactions required to fund the acquisition.

**Accounting**

Accountants and other experts on financial matters, tax matters, employment and pension matters and, as needed, areas of industry-specific expertise are also involved in the transaction. The accounting experts provide accounting support, including examination and analysis of financial statements. They often do detailed financial due diligence of the target company and help to explain and resolve accounting and other financial reporting issues.

**Others**

Other advisors involved in a transaction may include firms providing appraisals, solvency opinions, and fairness opinions. There may also be separate financing sources, for both debt and equity, and their respective legal teams.

**M&A Transactions**

For both public and private companies, M&A transactions may take the form of mergers, where pursuant to the provisions of corporate law, upon approval of the transaction by the requisite director and/or shareholder vote, the securities of the target or acquired company are exchanged for cash, debt or equity (or any combination thereof) of the acquiring entity. Other types of M&A transactions include a purchase and sale of assets, where specified assets and often specified liabilities are acquired and assumed by the acquiring entity, and a purchase and sale of shares or a statutory share exchange transaction, where the shareholders of the target company sell their shares to the acquiring company, resulting in the target company becoming a subsidiary of the acquirer. For these types of transactions, the consideration may be cash, debt or securities (or any combination thereof). It is possible to combine transactions, such as a purchase of shares (sometimes done through a tender offer by the acquiring
entity), followed by a merger to obtain ownership of shares not acquired directly.

**Frequent Types of Mergers**

There is no single type of merger transaction. Public companies are more likely to use their equity securities as consideration in a merger since they can register the shares and provide a liquidity option that is not available with the equity in a private company. Given the vast sums of capital available, cash is also used by both public and private companies. The assets and cash flows of the target can be used to support secured and unsecured debt obtained by the acquiring entity to finance the transaction. The result of these leveraged transactions is that the net worth of the acquired entity is reduced by the additional debt placed on it, the proceeds of which are paid out to its shareholders in the merger.

**Important Laws**

In the United States, a corporation is organized under the laws of one of the individual states, often the jurisdiction where the corporation was first located or the State of Delaware. State corporate laws provide statutory procedures for the authorization and approval of a merger, sale of all or substantially all of the assets, a share exchange and similar transactions. While the laws vary from state to state, generally the approval of a majority (Delaware) or two-thirds of the holders of common stock of the acquired company are required to approve a transaction. If a corporation has more than one class of stock authorized, the transaction may also require the separate vote of the other classes or series of capital stock. If the transaction is approved by the requisite shareholder vote, then upon the effective date of the merger and the filing of the certificate or articles of merger with the appropriate secretaries of state, the merger is effective and the shares of the acquired company thereupon represent the right to receive the form of consideration provided in the merger. Generally speaking, each state's laws provides that shareholders may “dissent” from a merger by following statutory procedures and, instead of receiving the merger consideration, are entitled to appraisal rights whereby a court may determine the fair value of their shares. There are exceptions to appraisal
rights in certain states’ laws for transactions where the consideration provided for in the merger is cash or where the securities of the target company were already publicly traded.

U.S. tax laws drive many of the terms and structure of a transaction. As a general rule, cash, and cash equivalents are taxable to shareholders upon receipt. Conversely, if the transaction is structured as a “reorganization” under Section 368 of the Internal Revenue Code, then to the extent the transaction involves the issuance of equity securities, the basis or tax cost of the shares owned by a shareholder of the target company is carried over to the equity securities issued in the merger transaction, and taxes are not payable until such securities are sold or disposed of. However, even in a “tax-free reorganization,” cash and debt is generally taxable upon receipt.

U.S. securities laws provide that the offer of securities of the acquiring company in exchange for the shares of the target is an offer and sale of securities. As such, securities can only be issued as consideration in the merger if they are registered, or if there is an applicable exemption from registration. Generally speaking, one exemption from registration involves the issuance of securities in a “private placement” to a limited number of sophisticated or high net worth persons or entities, where the securities are acquired for investment and not with a view for distribution and where there are restrictions on resale. Conversely, the U.S. securities laws provide for the ability to register the securities issued in a merger or other transaction, often by an acquiring company whose securities are already registered and traded publicly.

Various states have laws governing takeovers or change of control transactions, especially transactions that would involve plant closings within their states.

Companies engaged in specific industries, generally ones that are regulated, may also need to obtain various governmental approvals in order to consummate a merger. Examples are licensees under the Federal Communications Commission that must seek the commission’s approval for a change of control and holders of various healthcare licenses for regulated facilities or activities that may need approval from the
Department of Public Health in the state where the facilities or activities are located.

The U.S. Hart-Scott-Rodino Act applies to transactions of a minimum size (see the attached Appendix R). It requires that the constituent parties must file a pre-merger filing notification with the government and wait for expiration of a thirty-day waiting period before the transaction can be consummated. The filing includes information on the industry of the target company and the acquirer, and detailed information on sales, product overlap and the like. It is possible to request “early termination” of the waiting period, and it is also possible for the government to request further information and require a delay in closing the transaction until that information is provided and assessed. The government has the right to prevent a merger from going forward if it believes that the transaction would be anti-competitive. Sometimes, negotiations with the government will result in an agreement to divest one or more overlapping businesses as a condition to obtaining governmental approval. Hart-Scott-Rodino approval only applies to the United States and does not deal with the requirement to obtain approval from or make filings with regulatory authorities in other countries where both the acquirer and the target company are doing business.

Takeover Tactics

If a potential acquirer has identified a target company that it wants to acquire, it can approach the target company directly or through its investment bankers. This may be done by a written request to the target’s board for the opportunity to present a proposal, and, if rebuffed, by the announcement of a tender offer. If a company determines to be sold or acquired, the company can directly contact interested or potential acquirers identified by the company, or it can engage an investment banker to negotiate a sale with an identified party or to engage in an auction or other sale process to identify a potential acquirer.
Main Issues

The major issues a company needs to be aware of when engaging in an M&A transaction are the Hart-Scott-Rodino approval process, the corporate law requirements, and the tax considerations that will dictate the structure and timing of the transaction. If a public company is involved or securities will be issued as part of the consideration, the parties also need to be aware of the applicable securities laws and regulations that will affect the transaction.

Commonly Used Documents

The documents most commonly used in an M&A transaction are: a confidentiality or non-disclosure agreement; a letter of intent or term sheet; and a definitive agreement, such as an agreement and plan of merger or reorganization, an asset purchase and sale agreement or a stock purchase and sale agreement. Ancillary agreements may include: voting agreements; escrow agreements; exchange or transfer agent agreement; employment agreements; consulting agreements; leases; and license agreements.

The most important clauses in the definitive agreement are the description of purchase price and terms of the merger or other transaction; representations and warranties of each party; covenants (operation of the business and activity required to achieve closing); closing conditions; termination rights, possibly breakup fees (especially for public companies); and indemnity provisions (especially for private companies).

While each transaction is unique, the following summarizes the purpose of the various clauses in the definitive agreement:

• The purchase price and merger provisions set forth the detailed economic terms of the transactions, e.g., purchase price, exchange ratio or price, and adjustments, such as to determine the final value, normalize working capital or to deal with options and other rights, and, if a merger, the mechanics for consummation of the merger.
• The representations and warranties by the target company describe in detail the condition and business of the target company, and the due authorization and approval of the transaction and, as applicable, its shareholders, their share ownership and ability and authority to enter into and consummate the transaction. Similar, although often less extensive, representations and warranties are made by the acquiring company.

• The covenants address the actions the parties agree to undertake during the period between signing to closing, including obtaining any necessary regulatory and other approvals and how the target company will conduct its business pending closing.

• Closing conditions set forth the conditions to closing, including, as applicable, receipt of any necessary shareholder and regulatory approvals, registration of securities (as applicable), and closing of any needed financing, as well as the accuracy of representations and warranties, absence of material adverse changes and absence of litigation challenging the transaction.

• Termination rights set forth when the transaction may be abandoned, usually for breach by the other party, or if the transaction has not been completed by a specified date, and in the case of a public company a “fiduciary out,” if a more favorable transaction is proposed by a third party. Under certain circumstances, the acquiring company may be entitled to a breakup fee if the target company exercises its fiduciary out.

• The indemnity provisions deal with the rights of the parties, especially the acquiring entity, to be indemnified by the target company or its shareholders for breaches of representations and warranties, covenants and other specified matters (e.g., tax matters and often environmental liabilities, whether or not these constitute breaches of representations and warranties). The indemnity provisions, and the provisions on survivability of representations and warranties, are some of the most heavily negotiated provisions of any transaction (aside from the economic terms: price and form and timing of consideration). Negotiations involve the size of any deductibles or thresholds and caps on total liability. Escrow arrangements, offset rights, holdbacks or other forms of security
may support these indemnity obligations. In some transactions, especially ones involving the acquisition of the shares of a public company, the indemnity provisions may not survive closing.

**M&A Process**

The merger and acquisition process can be done as rapidly as thirty to ninety days, but it usually takes four to six months (and sometimes longer for heavily regulated companies). The process usually involves execution of a confidentiality or non-disclosure agreement, negotiating a term sheet or letter of intent describing the business deal, followed by a due diligence period, drafting and negotiation of the definitive agreement and ancillary agreements, seeking and obtaining regulatory approval (Hart-Scott-Rodino and any specific regulatory agencies overseeing the company (including any exchange on which the securities will be listed)), preparation of a proxy statement or other notices to shareholders, receipt of shareholder and regulatory approvals, and closing. If a public company is involved or the securities of a public company will be issued in the transaction, there may be filings with and review by the U.S. Securities and Exchange Commission.

**Valuation**

Companies are valued in various ways, but often as a multiple of free cash flow or earnings before interest, taxes, depreciation and amortization (EBITDA) or discounted cash flow, often adjusted to normalize working capital. Book value, multiples of net sales and multiples of earnings are also used.

Public companies are often valued as a multiple of earnings. Generally speaking, acquisition transactions for public companies are accomplished at a premium over the market price or, in a stock for stock exchange, as a ratio of shares. EBITDA is also used as a measure to assess value.

**Financial Statements**

Generally, an acquiring entity likes to review three years audited financial statements of the target company, as well as current financial statements for
the “stub” period. The due diligence process will often include examination of the target company’s accountant’s work papers, and detailed analysis of any “recast” or “pro forma” financial statements prepared by the target company, to eliminate onetime charges, non-recurring expenses, prior period restructuring charges, and to reflect synergies available to the acquirer.

A careful review of the footnotes to financial statements often provides information concerning contingent liabilities, changes in accounting practices and other significant areas which should be investigated in due diligence.

Consideration

The form of consideration (stock, cash or a combination of both) depends upon both the goals and objectives of the target company and the acquiring entity. Transactions involving the receipt of equity securities can be structured in a manner to defer any taxable gain on receipt of securities until they are sold or transferred (e.g., a tax-free reorganization). In any transaction involving securities, the transaction structure and terms often focus on liquidity options, such as registration rights or receipt of registered/tradable shares.

Due Diligence

Due diligence is a key element of any M&A transaction. It should be accomplished as a team approach, involving both legal, financial, business and other specialists. It should include document and financial review, review of the business and face-to-face meetings with the key executives of the target, and as appropriate, discussions with key customers and suppliers. The focus should be on understanding the business, to identify its strengths and weaknesses, understand the synergies, and any material liabilities and contingencies. The due diligence process should also identify how the integration process will happen post closing.
M&A transactions generally follow a similar process. They generally begin with execution of a confidentiality or non-disclosure agreement (which may include a lockup on hiring employees, and may provide for restrictions on trading in securities (if the target is public), and may restrict hostile transactions), followed by due diligence and negotiation of a letter of intent or term sheet, and then negotiation of the definitive and any ancillary agreements, obtaining shareholder and regulatory approvals, completing any required financing transactions and closing.

The Urge to Merge

There are a number of reasons why companies decide to engage in M&A activities. Computer systems have enabled companies to get larger and spread overhead over a broader base. Synergies enable companies to leverage their capital infrastructures, complete product offerings, provide strategic fit, diversify, and so forth. Opportunities for synergies provide the ability for the acquirer to pay what may be considered a premium over the current market value of a target company and still realize greater value going forward for its shareholders. For a target company, its shareholders may want liquidity, because it is a family business and its owners want to retire; because it is owned by an investment fund that wants to provide a return to its investors, or because it’s public and the market price does not reflect the intrinsic value of the business.

Why Deals Fail

Some of the most common reasons why M&A deals fall apart are due to unrealistic expectations of value, unresolved people issues (target management is concerned about ongoing employment), insufficient upfront due diligence before negotiation of a letter of intent or term sheet (followed by a renegotiation of the terms once due diligence is complete), and deal surprises—significant business or legal issues affecting the target company, which are not discovered until late in the due diligence process.
**Handling Negotiations**

Negotiations are often best handled, at least in the early stages, by investment bankers or lawyers as intermediaries, with involvement by the senior executives of the company. Positive interaction between executives of the companies can move the transaction forward and create the level of trust needed for a successful transaction.

**Good Advice**

Mergers are a process. While in almost any transaction one party is the acquirer and the other a seller, the seller’s management will often remain employed by the acquirer, which means that it is important to establish trust and build relationships early on, so that deal issues can be addressed in a win-win structure as opposed to one side believing it is being taken advantage of by the other. The best deals are where both sides leave the negotiating table thinking that, in the case of a seller that it has sold too low, and in the case of an acquirer, that it has paid too much. If both sides feel that way, they probably have reached a fair resolution.

**Useful Resources**

The U.S. Securities and Exchange Commission’s EDGAR database (www.sec.gov/edgar.html) is extremely helpful in finding examples of earlier transactions involving the target or the acquirer, if either is a public reporting company. Investment bankers and lawyers can provide research materials concerning deal terms and pricing for similar transactions, and can be helpful in identifying trends.

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