1985

The Acquisition Process and the Closely-Held Corporation: Selected Legal Aspects

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Recommended Citation

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I. INTRODUCTION

The world of corporate acquisitions and mergers is most often thought of as the domain of large, publicly-held enterprises and the 'M & A' (merger and acquisition) sections of the mammoth, big-city law firms.¹ The reality of the situation, however, is that all business enterprises, large and small, have an inherent tendency to seek economic growth.² Such growth may be generated internally or it may be achieved through a combination via an acquisition or merger with one or more other enterprises. In the daily practice of the corporate attorney, it is not at all uncommon for an acquisition to occur between two or more closely-held entities and it is common for an acquisition including a publicly-held entity also to include a closely-held entity.³

³ Statistics do not appear readily available on the involvement of closely-held entities. To obtain a sampling, the author asked ten different corporate attorneys from six different cities to consider the involvement of closely-held corporations in acquisitions they have been involved in over the past two years. A substantial number of the acquisitions involved at
As part of its efforts to grow economically, a closely-held entity may seek to acquire another business for a variety of reasons, including: (1) to attain cumulative growth through the acquisition of a like entity; (2) to create a synergistic growth effect by the infusion of complementary resources; (3) to assert its position in a given product market; (4) to expand its geographic market; (5) to diversify its business operations; and (6) to invest accumulated surplus cash. In turn, a closely-held entity may seek to be acquired by another entity because the acquisition offers a suitable means: (1) to liquidate the owner’s investment (which may be a more desirable alternative than going public); (2) to raise needed capital for at least one closely-held corporation. It also appeared that most of the closely-held entities were inclined to retain their regular counsel to represent them. It should be noted that some of the acquisitions included unincorporated businesses such as partnerships and sole proprietorships. This Article, however, will be concerned only with acquisitions involving two or more incorporated entities.

4. On reasons for merging, see generally P. Steiner, supra note 2. See also Shad, Business and Financial Fundamentals, in Kramer & McCord, Mergers and Acquisitions 3-24 (1969).

5. The ‘going public’ process is often thought of as an ideal way for owners of closely-held entities to make their investment liquid. The process, however, is extremely complex and expensive, and on a long-term basis involves substantial adjustments in the way of doing business. After thinking through the matter, owners may conclude that it is unfeasible or undesirable to go public, and that an acquisition or merger is the better alternative. For discussion of the ‘going public process’ and its consequences, see Schneider, Manko & Kant, Going Public—Practice, Procedure and Consequences, 27 Vill. L. Rev. 1 (1981); Schneider & Shargel, “Now That You Are Publicly Owned . . . ,” 36 Bus. Law. 1631 (1981).

In this context of liquidating an owner’s investment, there has arisen in recent years a fairly prevalent use of the leveraged buy-out acquisition technique by publicly-held companies desirous of divesting themselves of closely-held subsidiaries and by owners of mature privately-held companies. A leveraged buy-out is not a legal form of acquisition, but rather a sophisticated financing technique used for acquisitions. It is based on a high degree of ‘leverage’ (in other words, a large degree of debt) and relies on the assets or cash flow of the acquired company to service the debt. A common example of a leveraged buy-out of a closely-held corporation involves a well-seasoned, profitable business with good management, whose controlling owner desires to liquidate his or her ownership position and whose key management desires to acquire and to continue the business. In conjunction with the selling owner and/or outside financial institutions or investor groups, the acquiring management will attempt to refinance the business in a manner that will permit them to meet the economic objectives of the selling owner and to meet their primary objective of acquiring the business largely through credit based on the business itself. In doing so, the purchasing management will employ one of the traditional legal forms of acquisition which will be effected through a new corporate entity formed by the purchasers for the purpose of the acquisition. In this legal sense, a leveraged buy-out presents many of the same considerations as the various acquisition forms discussed in this Article. Because the buyout involves a refinancing of the business, however, this acquisition technique presents numerous other legal considerations. Also, because many buyouts involve affiliated parties (for example, selling shareholders, directors, and officers), special fiduciary concerns may arise respecting the fairness of the transaction. For further consideration of the leveraged buy-out, see H. Ben-
the continuance and growth of the enterprise; (3) to exchange their ownership interests for a more liquid position in a public corporation; and (4) to facilitate estate planning.

This Article is designed to serve as a ‘primer’ for owners of closely-held corporations and their attorneys concerning the myriad legal implications of a corporate merger and acquisition. The legal forms of corporate combinations are:

(i) merger or consolidation, which requires a filing with, and approval of, the relevant state(s) and which occurs by corporate action and by operation of law;
(ii) stock acquisition, which generally is effected on a consensual basis between the acquiring corporation and the shareholders of the acquired corporation and which (if successful) results in a parent-subsidiary relationship; and
(iii) acquisition of substantially all assets of the acquired enterprise, which occurs largely through contract and, in part, through corporate action under relevant state statute.*

Each of these forms of combination involve significant business, accounting, and legal planning.

The general legal considerations entailed in an acquisition may include the substantive and procedural requirements of state corporation codes, special statutory and case law protections for shareholders, basic contract and property law notions, fiduciary duties, labor and employment matters, and antitrust provisions. In addition, when there is an offer to purchase or to sell securities, or a publicly-held enterprise is one of the parties to the transaction, special securities law considerations may be

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6. See app. 1 to this Article, infra p. 612 for a series of charts depicting the results of these various legal forms of corporate combinations. This Article considers the various legal forms from the perspective of a single-stage, negotiated transaction, and does not consider the additional and particularized legal implications that may arise from a multiple-stage acquisition (for example, private purchases of stock, followed by a tender for stock, and completed with a short-form or long-form merger) or from an unfriendly acquisitive takeover.

involved. Complex federal income tax requirements and special accounting requirements will have to be considered in structuring the transaction, especially if tax-free treatment is desired.

The business lawyer plays an integral role in the acquisition planning process. The lawyer is the person who, through legal planning and counseling, the corporate review, proper documentation of the transaction, orchestration of the closing of the transaction, and preparation and delivery of the legal opinion, facilitates the consummation of the transaction and ensures the legal integrity of the transaction. The lawyer ensures that the transaction is legally binding and enforceable. Throughout this Article, the role of the attorney in the acquisition process will be stressed.

II. THE LEGAL FORMS OF CORPORATE COMBINATION

In economic terms and results, there is substantial similarity between the various legal forms of corporate combinations. These combinations include the statutory merger or consolidation, the stock acquisition, and the acquisition of substantially all assets of the acquired enterprise. The assets of two or more enterprises are effectively combined into a single economic unit, generally under common management. The various forms, however, impart significant legal differences that give rise to numerous legal and business considerations.

A. Statutory Merger or Consolidation

All state corporation codes contain specific provisions permitting the combination and fusion of two or more corporations through merger or consolidation. If these statutory provisions are followed, the relevant state corporate authority (normally the Secretary of State) will issue a...
'Certificate of Merger.' The legal significance of this Certificate of Merger is that, by operation of law, the corporations (with all of their attendant assets and liabilities) are fused, with one of the corporations being the surviving corporation and the other entity automatically ceasing to exist.\textsuperscript{12} A statutory merger is effected on the corporation level; that is, the transaction is initiated and negotiated by the managements of the included corporations subject to approval at board of directors and shareholder meetings.\textsuperscript{13} Once the transaction is approved by the requisite percentage of directors and shareholders of each corporation and the requisite filing with the state(s) has occurred, the state corporate authorities issue a formal certificate declaring the merger to be effective.\textsuperscript{14} The shareholders of the surviving corporation retain their shares, and the shareholders of the acquired corporation (irrespective of whether they dissented from the transaction) become shareholders of the surviving cor-


\textsuperscript{13} It is important to note that only the Board of Directors can initiate a merger. See, e.g., O.C.G.A. § 14-2-211 (Michie 1982).

\textsuperscript{14} The following is a sample form of Certificate of Merger that is utilized by many state authorities:

\begin{verbatim}
STATE OF ................................
OFFICE OF THE SECRETARY OF STATE

CERTIFICATE OF MERGER
OF DOMESTIC CORPORATIONS
INTO

The undersigned, as Secretary of State of the State of ........................................
........................................ hereby certifies that duplicate originals of Articles of
Merger of ........................................, a domestic corporation, into ........................................, a domestic corporation, duly signed
and verified pursuant to the provisions of the ........................................ Business Corporation Act, have been received in this office and are found to conform
to law.

ACCORDINGLY the undersigned, as such Secretary of State, and by virtue of the
authority vested in him by law, hereby issues this Certificate of Merger of ...........
........................................ into ........................................, and attaches hereto a duplicate
original of the Articles of Merger.
Dated ........................................, 19 ...........

........................................
Secretary of State

Source M.B.C.A. Official Form No. 22, Section 74.
\end{verbatim}
poration (if stock is the entire or partial consideration) or they are ‘cashed-out’ (if cash or property other than stock in the surviving corporation is the sole consideration). In a merger, the actual consideration permitted is entirely flexible. Cash, stock, property, or combinations of the foregoing are permitted.15

The typical sequence of events in a merger begins with negotiation between managements of the concerned companies. Next there will be formal consideration and resolution by the boards of directors, submission by the boards (who have the exclusive power of initiation of shareholder action) to the shareholders for the requisite approval, and filing of the requisite documents with the relevant state corporation authorities.16

Significantly, in the statutory merger, the corporate combination occurs by operation of law. There is, therefore, no further need to convey assets or liabilities or to liquidate the corporation that is going out of existence. The result is that, through compliance with the statutory provisions and the formal act of the relevant state, the assets and liabilities of both corporations come together within the legal solution: the surviving corporation.17

In sum, the merger form presents the simplest, most complete, most flexible, and most effective means of combining two or more corporate enterprises. A primary disadvantage of this form, however, rests in the completeness of the transaction, in that the surviving corporation takes upon itself not only all the assets of its acquired corporation, but also all of its liabilities, whether known or unknown, fixed or contingent. In addition, dissenting shareholders of both corporations usually have statutory appraisal rights. Moreover, as with any other form of combination, if securities constitute part of the consideration, or if a public enterprise is involved, federal and state securities law constraints may apply.

As will be discussed below, for tax purposes, the statutory merger or consolidation is also the most flexible form of acquisition, being commonly referred to as the ‘A’ reorganization.18

B. Stock Acquisition

Although, as discussed below, the Model Business Corporation Act con-

15. See app. 1, infra p. 612, Diagrams 1 & 2.
16. See Business Associations, supra note 7, chs. 1, 2, 4, and 6.
18. See infra section IV(C).
tains express provisions dealing with stock acquisitions, most state corporation codes do not contain any provisions dealing with this mode of corporate combination. Legally, the stock acquisition is largely a matter of contract between the acquiring corporation and the shareholders of the acquired corporation. Under this form, the acquiring corporation does not deal directly with the management of the acquired corporation. Instead, it deals directly with the individual shareholders of the acquired corporation respecting the purchase of their shares for cash, stock, or other property. Yet, in reality, the position of the management of the acquired corporation is most relevant to the transaction. For instance, in a friendly stock acquisition, management of the acquiring corporation will discuss the terms of the offer with the management of the acquired corporation and will seek their recommendation to the shareholders of the acquired corporation to proceed with the transaction. In an unfriendly situation, the stock acquisition form is often necessitated, because a merger or acquisition of substantially all of a corporation’s assets requires the approval and recommendation of the board of directors of the acquired corporation.

Unlike a merger, in which the acquired corporation goes out of legal existence, in a stock acquisition both the acquired and the acquiring corporations maintain their separate legal existences. What happens legally is that the acquiring corporation acquires the stock of, and becomes the parent of, the acquired corporation. If the consideration is stock, the tendering shareholders of the acquired corporation become shareholders of the acquiring corporation. If the consideration is cash, the tendering shareholders of the acquired corporation receive cash for their shares and ‘go away,’ with the non-tendering shareholders remaining as shareholders (most often in a minority position) of the acquired corporation.

The stock acquisition form offers numerous advantages, including simplicity, since there is no actual transfer of assets and liabilities. In addition, no shareholder vote of either corporation and no directors’ vote of

22. The ‘unfriendly’ takeover may entail highly sophisticated legal strategy and techniques, both with respect to the takeover company and the resisting target company. Discussion of these matters is not within the scope of this Article. See A. Fleischer, Tender Offers: Defenses, Responses and Planning (1978); M. Lipton & E. Steinberger, Takeovers & Freezesouts (1978); Shark Repellents and Golden Parachutes: A Handbook for the Practitioner (R. Winter, M. Stumpf & G. Hawkins eds. 1983).
the acquired corporation is required. Dissenting shareholders usually have no rights concerning their position in the transaction, and the corporate identity of each corporation is preserved. Furthermore, the stock acquisition mode may be desirable because it may circumvent statutory or contractual restrictions on mergers or sales of substantially all assets. For example, some state corporation statutes restrict mergers between domestic and foreign corporations, or otherwise provide that such corporations may merge only if they are empowered to engage in the same or similar businesses. In addition, many loan agreements, mortgages, indentures, patent licensing agreements, and material leases may have contractual provisions barring a statutory merger of a sale of substantially all assets, but not barring a stock acquisition.

It is often stated that the primary advantage of a stock acquisition is that the assets of the acquiring corporation are not exposed to any known or contingent liabilities of the acquired subsidiary, inasmuch as the position of the acquiring corporation is that of a stockholder with limited liability. While this is true, it must be remembered that if there exists any known or contingent liabilities of the acquired corporation, this will reduce the value of the acquiring corporation's investment. In other words, an apparently good deal becomes a bad deal.

A primary disadvantage of a stock acquisition is that it is voluntary in character, inasmuch as there is no assurance that all shareholders will tender their shares. In fact, in a stock acquisition involving any significant number of shareholders, it is virtually certain that minority shareholders will remain. If, however, the acquiring corporation obtains a large enough ownership interest in the acquired company through the stock acquisition, then it might be possible (subject to fiduciary duty and possible securities laws constraints) subsequently to cause a merger of the acquired subsidiary into the acquiring corporation that would eliminate the minority shareholders.

The actual scenario in a normal stock acquisition begins with formal negotiations concerning the price and other material terms of the offer between the managements of the involved companies. A formal agreement between the companies is then drafted, under which the management of the acquired company will recommend and approve the transaction; and a formal offer is made to the shareholders of the acquired company. If cash is the consideration, this form of offer will generally be termed a 'cash tender offer.' If securities are the consideration, the offer

25. For discussion of these loan covenants, see TERM LOAN HANDBOOK § 11.4 (J. McCann ed. 1983).
will be deemed an ‘exchange offer.’ These transactions are similar, except that in a cash tender offer, the tendering shareholders of the acquired corporation will be ‘cashed out’ of the enterprise, while in an exchange offer, the shareholders of the acquired corporation will become additional shareholders of the acquiring corporation. In addition, an exchange offer may require formal shareholder action to amend the charter documents of the acquiring corporation if the documents do not authorize the issuance of a sufficient number of shares to consummate the transaction.27

A stock acquisition may be subject to federal and state laws on takeovers and to general federal and state securities laws if the consideration is stock or a public corporation is involved. A stock-for-stock exchange may qualify as a tax-free ‘B’ reorganization if stringent statutory and regulatory requirements are met.28

C. Acquisition of Substantially All Assets

All state corporation statutes have specific provisions dealing with the acquisition of substantially all the assets of a corporation, regardless of whether the consideration is stock, cash, or other property.29 These procedures require a formal shareholder vote of the selling corporation and give rise to appraisal rights for the shareholders of such corporation. Sales of assets effected in the ‘usual course of business’ are generally excepted from such procedures even if the sale is for substantially all of the assets, although formal board of director approval is required.30

A “sale of substantially all assets . . . not in the usual or regular course of business”31 is not necessarily a quantitative determination, but may entail qualitative assessments. For example, the sale of the key operating asset of a corporation may not involve a dollar majority of its assets, but may still be a ‘sale of substantially all assets’ for state code purposes.32

Like a merger, this transaction is directly between the corporations. In this transaction, however, the acquiring corporation, by contract, acquires

28. See infra section IV(D).
32. See app. 1, infra p. 612, Diagram 5.
specified assets and liabilities of the acquired corporation. The consideration is paid directly from the acquiring corporation to the acquired corporation, and the latter corporation remains in legal existence. As a practical matter, the acquired corporation normally either dividends out the consideration to its shareholders or is liquidated, and the assets are distributed to the shareholders. In this situation, the material assets of the acquired corporation are transferred to the acquiring corporation and the acquired corporation goes out of existence or remains a ‘shell.’ In those transactions in which the consideration received by the acquired corporation is stock of the acquiring corporation, the shareholders of the acquired corporation become shareholders of the acquiring corporation. Accordingly, the result of most asset acquisitions is substantially similar to the result of a merger.\textsuperscript{33} Indeed, this form of transaction is often dubbed a ‘practical merger.’

Unlike a merger, however, which requires formal action from the corporate organs of both corporations, the state statutes regulating asset acquisitions require only formal action of the shareholders of the acquired corporation. Thus, unless it is necessary to amend the articles of incorporation of the acquiring corporation as a result of the transaction, the shareholders of the acquiring corporation do not vote upon the transaction.\textsuperscript{34}

A primary advantage of the asset acquisition is that the acquiring corporation does not take upon itself any assets or liabilities for which it does not specifically contract.\textsuperscript{35} Moreover, no formal documentation is required to be filed with the state nor is any formal approval of the state corporate authorities required. Yet, there is a completeness to the transaction: Once the requisite shareholder vote of the acquired corporation is obtained, the transaction may be effected, regardless of the dissent of minority shareholders of the acquired corporation (whose only remedy is generally their statutory appraisal rights).

A major disadvantage of the asset acquisition is that the process is complex and cumbersome. Unlike a merger, in which assets and liabilities pass by operation of law, an asset acquisition requires the seller to transfer to the purchaser specified assets and liabilities by contract. The conveyances, therefore, must be effected by deed, bill of sale, assignment, certificate of title, or other applicable instrument. In a major asset acquisition, this process can be extremely time-consuming and expensive. In

\textsuperscript{33} See H. HENN & J. ALEXANDER, LAWS OF CORPORATIONS 963 n.16 (3d ed. 1983).

\textsuperscript{34} It may be necessary to have shareholder authorization of the issuance of additional stock to be used as consideration for the acquisition, if there is not sufficient capital stock authorized by the articles of incorporation.

addition, the transaction may be subject to the state bulk sales provisions of the Uniform Commercial Code.\textsuperscript{36} If various requirements are met, an asset acquisition for stock may qualify as a tax-free 'C' reorganization.\textsuperscript{37}

D. 'Triangular' Mergers

In recent years, a new variant of the merger has arisen that has been accommodated by most state corporation codes: the triangular merger.\textsuperscript{38} In a triangular merger, the acquiring corporation will create a new subsidiary solely for the purpose of effecting the acquisition. The acquiring corporation will place in the subsidiary, in exchange for all of the stock of the subsidiary, the consideration to be used in consummating the merger. The acquired corporation may be merged into the new subsidiary (a 'forward triangular merger') or the new subsidiary may be merged into the acquired corporation (a 'reverse triangular merger'). In the forward triangular merger, when stock of the acquiring corporation is the consideration for the merger, the shareholders of the acquired corporation receive the stock of the acquiring corporation rather than the stock of the surviving subsidiary. The end result is that the former 'shell' subsidiary, which is a wholly owned subsidiary of the acquiring corporation, will have the assets and liabilities of the acquired corporation fused into it, and the former shareholders of the acquired corporation will become shareholders of the acquiring corporation. If the consideration used in the merger is cash, the shareholders of the acquired corporation will receive cash for their shares and then 'go away.' The same results will occur in a 'reverse triangular' merger, except that the subsidiary will be merged into the acquired corporation, with the acquired corporation becoming a wholly-owned subsidiary of the acquiring corporation. The reverse form is often chosen when there is a contract, license, or material right that must remain in the acquired corporation.\textsuperscript{39}

The practical result of the triangular merger is similar to that of an exchange of stock: a parent-subsidiary relationship is created. The ad-

36. See U.C.C. art. 6 (1977), which prescribes a statutory notice procedure to make 'bulk sales' effective against creditors. As such, compliance with the bulk sales laws will affect the timing of the acquisition. If such compliance is waived, the acquiring corporation should carefully assess its liability and should obtain appropriate indemnifications from the selling corporation and/or its principal owners.

37. See infra section IV(E).


advantage of the triangular merger over the exchange offer is that, through the merger statutes, there will be no minority shareholders in the surviving subsidiary. A disadvantage is the requisite corporate action and other requirements of a state’s merger laws. There are special tax considerations for effecting a tax-free reorganization using a triangular merger.

E. The Choice

The actual choice of acquisition form is generally made only after a full assessment of the following: Business motives and objectives of the companies, tax and accounting considerations of both enterprises and their respective shareholders, required timing of the transaction, shareholder approvals that may be required, requisite governmental approvals, the existence of statutory or contractual impediments, the relative bargaining positions of the parties, the position of management of the acquired corporation favoring or disapproving the combination, and the impact of securities laws involving issuance of shares, solicitations of proxies, or takeovers. There is no standard solution. A separate decision must be based upon the relevant circumstances of each transaction.

III. General Legal Considerations

A. Contract and Property Notions

As in all other business and commercial transactions, the law of contracts plays a significant role. Any form of corporate acquisition or combination will entail numerous contractual arrangements and documents to consummate the transaction. The terms of pre-existing agreements, such as shareholder agreements, loan agreements, indentures, major business contracts, licensing agreements, and mortgages, may also contain contractual provisions that restrict or otherwise require consent for the consummation of the transaction. Failure to obtain such consents could give rise to a material default under such pre-existing agreements.

The interpretation, enforcement, and remedies for breach of an acquisi-
ACQUISITION PROCESS 579

tion agreement are essentially a matter of state contract law.\textsuperscript{46} It is unclear whether Article Two of the Uniform Commercial Code is applicable to acquisition situations. Article Two applies to transactions in "goods," a term which includes "all things . . . which are movable . . . other than . . . investments and securities."\textsuperscript{46} As in a transaction involving a sale of assets, it appears that Article Two (at least to the extent applicable to "goods") would apply to the transaction.\textsuperscript{47} Article Two of the U.C.C. contains special rules and remedies unlike the common law of contracts.\textsuperscript{48} Also, as previously mentioned, a sale of assets may come under the bulk sales provisions of Article Six of the U.C.C.\textsuperscript{49}

In addition to basic contract notions, acquisitions invariably involve the transfer of some form of property. In a merger, the transfer occurs by operation of law; in the stock acquisition, there is no transfer of assets except the stock; and in the asset acquisition, the transfers are effected by contract and by traditional property rules. With respect to the transfers in an asset acquisition, real property needs to be conveyed by deed, personal property by bill of sale, contract rights by assignment, and special property, such as motor vehicles or airplanes, by certificate of title or government authorization.\textsuperscript{50} In a stock acquisition, the transfer is subject to state and federal securities laws and constitutes a sale of personality, which is now governed by the U.C.C. or its equivalent under the relevant state law.\textsuperscript{51}

B. Corporate Action

The effectuation of a corporate combination, depending upon its legal form, may entail various corporate actions on the board of director or shareholder level. The requirement of such corporate action may weigh heavily in the final business decision concerning the legal form of the acquisition. For example, if a shareholder vote is required for a public corporation, this will mean the use of the federal proxy system, which in

\begin{itemize}
\item[45.] On contract aspects, see Weinreich, Contract of Sale, in BUSINESS ACQUISITIONS, supra note 7, ch. 5; Dillport, Breaches and Remedies in BUSINESS ACQUISITIONS, supra note 7, ch. 31. For a sample form of acquisition agreement (stock purchase), see Glickman, A Stock Purchase Agreement, 3 ALI-ABA COURSE MAT. J. No. 2, 65 (1978). See also Borden, Drafting a Purchase Agreement for the Acquisition of a Closely-Held Business, 12 PRAC. LAW. 9 (1966).
\item[47.] See White & Summers, UNIFORM COMMERCIAL CODE, Intro. and ch. 1-2 (2d ed. 1980).
\item[48.] See generally U.C.C. art. 2 (1977).
\item[49.] See supra note 36.
\item[50.] For a discussion of real property conveyances, see generally M. FRIEDMAN, CONTRACTS AND CONVEYANCES OF REAL PROPERTY (3d ed. 1975).
\item[51.] See U.C.C. art. 8 (1977).
\end{itemize}
turn will entail considerable time, expense, and public disclosure.\textsuperscript{52} Also, as a practical matter, it may not be possible to secure the requisite shareholder vote in a given transaction.

**Merger.** A merger must be initiated by the boards of directors of the various companies involved.\textsuperscript{53} Each board has the discretion to recommend the transaction to the shareholders for a formal vote, with the board's determination generally being subject to the 'business judgment rule' (absent fraud or self-dealing).\textsuperscript{54} The requisite shareholder vote will vary according to the relevant state corporation codes. The state law may require a simple majority of shares entitled to vote or up to a two-thirds majority of each class of outstanding securities of the corporation (whether or not such shares are otherwise entitled to vote).\textsuperscript{55} This shareholder vote may be even higher, if expressly provided for in the company’s articles of incorporation.\textsuperscript{56}

A significant aspect of a merger is that action by each corporation's board of directors must be followed by shareholder approval in accordance with statutory requirements. It should be noted, however, that there may be several statutory exceptions to the requirement of a shareholder vote.

(a) **Short Form Merger**—Many state corporation codes contain provisions that are designed to accommodate the realities of a merger between a parent and its “almost wholly-owned” subsidiary.\textsuperscript{57} For example, under the Model Business Corporation Act, if a parent corporation holds at least ninety percent of the subsidiary's stock, the merger may be effected through appropriate resolutions of the board of directors of the parent, with no action being required by the board or the shareholders of the

\textsuperscript{52} See infra section V(A).

\textsuperscript{53} MODEL BUSINESS CORP. ACT § 71 (1969); DEL. CODE ANN. tit. 8, § 251(b) (1974); O.C.G.A. § 14-2-210(b) (Michie 1982).

\textsuperscript{54} For a discussion of “business judgment rule” (including key citations and cases) see Ribstein, supra note 7, at § 7.03.

\textsuperscript{55} See, e.g., DEL. CODE ANN. tit. 8, § 251(c) (1974); MODEL BUSINESS CORP. ACT § 73 (1969 & Supp. 1977) requiring a majority vote; but, the Texas Business Corporation Act (TEX. BUS. CORP. ACT) art. 5.03 requires a two-thirds vote (unless lowered in the articles of incorporation to no less than a majority) of each class of stock whether or not entitled to vote. O.C.G.A. § 14-2-212(c) (Michie 1982) requires a majority vote of all shares entitled to vote.

\textsuperscript{56} E.g., MODEL BUSINESS CORP. ACT § 143 (1969 & Supp. 1977) permits a greater vote than the statutory prescribed norm if contained in the corporation's articles of incorporation. Under TEX. BUS. CORP. ACT art. 9.08 a greater vote or a lower vote not less than a majority is permitted because the statutory norm is two-thirds. Under O.C.G.A. § 14-2-118 (Michie 1982) a greater vote than the statutory prescribed norm is permitted if contained in the corporation's articles of incorporation.

\textsuperscript{57} See, e.g., O.C.G.A. § 14-2-214 (Michie 1982).
subsidiary.\footnote{58. \textit{MODEL BUSINESS CORP. ACT} § 75 (1969).} While no shareholder approval is required, certain states may require prior notice to minority shareholders of the subsidiary corporation. Other states, however, including Delaware, do not require that any prior notice be given to any minority shareholders, although notice is required within a short period of time after the event.\footnote{59. \textit{DELC. CODE ANN. tit. 8, § 253 (1974).}}

(b) \textit{Mergers Between Corporations of Disparate Size—The Model Business Corporation Act provides that if the number of outstanding shares of the larger corporation will increase by no more than twenty percent, and if there is no significant change in its article of incorporation by virtue of the merger, shareholder approval of the larger corporation is not required.\footnote{60. \textit{MODEL BUSINESS CORP. ACT} § 75 (1969). \textit{See also DEL. CODE ANN. § 251(f) (1974); cf. O.C.G.A. § 14-2-212(a) (Michie 1982).}} If such corporation has its shares traded on a national stock exchange, however, then the rules of the exchange will generally require such a vote, notwithstanding the absence of a requirement under state law. In such case, if a vote is not taken, the new additional shares will not be permitted to be listed on the stock exchange.\footnote{61. \textit{See, e.g., New York Stock Exchange, COMPANY MANUAL, A283-284.}}

(c) \textit{Triangular Mergers—As discussed above, in a triangular merger the acquiring corporation will set up a wholly-owned subsidiary for the purpose of effecting the transaction. Thus, in a strict legal sense, the acquiring corporation is not a 'constituent' corporation to the transaction, and therefore is not required to obtain the approval of its shareholders. As the acquiring corporation is the sole shareholder of the subsidiary, its consent as a shareholder is, of course, perfunctory.\footnote{62. \textit{See supra} section II(D).}}

\textbf{Stock Acquisition.} In most instances, no corporate action will be required in a stock acquisition, except possibly for a resolution of the board of directors of the acquiring corporation.\footnote{63. A formal board resolution may be required by a corporation's articles of incorporation, bylaws, prior resolution, or a shareholder agreement. Even absent this requirement, it is often the most prudent course to have a resolution to avoid any subsequent disputes concerning who has the authority to negotiate the transaction, who may execute the relevant documents, and the scope of this authority.\footnote{64. \textit{See MODEL BUSINESS CORP. ACT} § 72A (Supp. 1977).}} No formal shareholder approval of the acquired corporation is required, since the transaction is effected on a consensual or contractual basis between the acquiring corporation and the individual shareholders of the acquired corporation.

Generally, the decisions by the shareholders of the acquired corporation whether to tender their shares are individual decisions. Recent amendments to the Model Business Corporation Act\footnote{65. \textit{See supra}} and the corpora-
tion laws of a few states, however, now provide a formal procedure by which all of the shareholders of the acquired corporation (subject to an exercise of statutory appraisal rights) are compelled to accept a plan for a share exchange if it is approved by a majority of the acquired corporation's outstanding shares and approved by the directors of the acquiring corporation. In effect, this new provision, which has been accepted on only a very limited basis among the states to date, provides procedures for a stock acquisition equivalent to those for a sale of substantially all assets. It should be noted that under this alternative statutory treatment of stock acquisitions, a formal vote of the shareholders of the acquired corporation will be required and statutory appraisal rights that previously had not existed are provided.

Asset Acquisition. In a sale of substantially all assets, the board of directors of the acquired corporation must make a recommendation to its shareholders. The shareholders must then approve the transaction, although some states permit a lesser percentage of shares to approve the sale of assets than would be required to approve a merger. No similar statutory requirement exists for the acquiring corporation. In most instances, however, the board of directors will pass appropriate corporation resolutions. Shareholder approval by the acquiring corporation will be required if subject to a stock exchange rule concerning the issuance of new shares in an amount exceeding twenty percent of the number outstanding.

Amendment to Charter Documents. In addition to the corporate


This section [§ 72A] which was added to the Model Act in 1976, in effect compels all of the shareholders of the acquired corporation (unless they choose to exercise their appraisal rights) to accept a share exchange approved by a majority of the acquired corporation's outstanding shares. The draftsmen of this provision, recognizing that the differences between a merger or consolidation and a stock swap were almost entirely formal, sought to make the two more equivalent in practice by depriving would-be “hold-outs” among the acquired corporation's shareholders of an option that they would have if the transaction was cast in the form of a merger. Giving the planners of corporate combination this option also eliminates the practical and legal difficulties that often lead to freeze-outs.

Id.


68. See supra note 61.
actions described above, if a transaction involves the issuance of shares that have not yet been authorized, or engagement in an activity that is not authorized or contemplated by the articles of incorporation, then a formal amendment to the articles of incorporation of the acquiring corporation will be necessary. Such an amendment will entail not only board resolution, but approval by the shareholders. In a public corporation, the shareholder vote will be subject to the federal proxy regulations.

C. Shareholder Protection

Under traditional common-law principles, a shareholder had a vested right to retain his ownership interest in the corporate entity in which he had invested. Any fundamental change such as merger, sale of assets, or dissolution required the unanimous consent of shareholders. As general enabling corporation codes came into existence, however, this vested rights concept began to erode. Notwithstanding this erosion, the state corporation code and especially state case law have remained sensitive to the oppression of minority shareholders. This concern may be expressed in a number of ways.

Formal Shareholder Vote. This matter has been discussed above.

Appraisal Rights. With the statutory shift from common-law requirements of unanimity to less than unanimous shareholder approval for these fundamental changes entailing corporate acquisitions or combinations, the need for some appropriate statutory vehicle for protecting the minority's interest arose. This need is now addressed, in most states, by statutory appraisal rights, a device that finds its origin in the courts of equity.

Appraisal rights permit dissenting shareholders to be paid in cash the value of their shares as determined through a formal judicial appraisal. The availability of this shareholder right or remedy may vary from state to state. Virtually all states have such rights for the shareholders of both the acquired and acquiring corporations in mergers, and most states

70. See infra section V(A).
71. See H. Henn & J. Alexander, supra note 33, at 952.
72. Id. at 955-59.
74. See supra section II(C).
75. For discussion of development of and policies behind appraisal rights, see M. Eisenberg, The Structure of the Corporation ch. 7 (1976); Buxbaum, Dissenter's Appraisal Remedy, 23 U.C.L.A. L. Rev. 1229 (1976).
77. See, e.g., Del. Code Ann. tit 8, § 262(b) (1974); O.C.G.A. § 14-2-250(a)(1) (Michie
have this remedy for shareholders of the acquired corporation in a sale of substantially all corporate assets. Some states also provide this remedy in certain corporate recapitalizations and fundamental amendments to corporate charters. In addition, as mentioned above, the recent amendments to the Model Business Corporation Act and certain state corporation codes will now provide appraisal rights when a formal shareholder vote in a stock acquisition is utilized. Appraisal rights are often not available in the case of a short-form merger. Furthermore, states such as Delaware preclude appraisal rights in mergers or sales of assets when the shareholders of the acquired corporation receive stock that is listed on a national stock exchange.

The procedural requirements for instituting an appraisal proceeding are complex and must be followed strictly. Ordinarily, to exercise such right, a dissenting shareholder must give prior written notice of intent to dissent and then, depending upon the particular provisions, demand payment, tender his share certificates, and refrain from voting in favor of the corporate action. If the statutory time period and procedures are not complied with strictly, the shareholder will generally lose these rights. In addition, if the corporation contests the appraisal proceedings (which must be brought on an individual basis rather than as a class-action), these proceedings may become very lengthy and costly for the shareholder. Subject to the outcome of the appraisal proceedings, a dissenting shareholder effectively loses his status as a shareholder, including his right to dividends. The shareholder, however, may have a right to receive interest on the value of his shares.

One of the most difficult aspects of a judicial appraisal proceeding is the actual valuation of the corporate shares. A typical state appraisal statute speaks in terms of the ‘fair value’ of the shares. This terminology,


78. See, e.g., O.C.G.A. § 14-2-250(a)(2) (Michie 1982 & Supp. 1984). No such requirement, however, exists under the Delaware General Corporation Law.
80. See Conard, Amendments of Model Business Corporation Act Affecting Dissenter’s Rights (Sections 73, 74, 80 and 81), 33 BUS. LAW. 2587 (1978).
81. See, e.g., DEL. CODE ANN. tit. 8, §§ 251(f), 262(k) (1974); but see discussion of Weinberger, infra notes 88-89 and accompanying text.
82. DEL. CODE ANN. tit. 8, § 262(b)(1) (1974), which also excludes appraisal rights if the shares are held by record by not less than 2,000 stockholders, and if, in the case of the surviving corporation, shareholder approval is not required.
83. E.g., O.C.G.A. § 14-2-251 (Michie 1982).
85. For a discussion of the mechanics involved in an appraisal rights statute, see Henn & Alexander, Appraisal Remedy, 2 N.Y. BUS. CORP. L. 623-25 (19__.) (app. 4, checklist 8).
however, simply begs the question concerning the appropriate method of valuation. A common way of evaluating shares is the so-called ‘Delaware block’ or ‘weighted average’ method, whereby the elements of value—the assets, market price, and earnings—were assigned a particular weight, with the resulting amounts added to determine the value per share. In the recent case of Weinberger v. UOP, Inc., however, the Delaware Supreme Court appeared to be proposing a more liberal approach to appraisal, whereby any technique or method that is generally considered acceptable in the financial community, acceptable to the court, and consistent with statutory requirements, may be considered and utilized by the court. Serving as a persuasive but nonbinding precedent outside of Delaware, the decision in Weinberger most likely will be limited to certain ‘freeze-out’ merger situations not formally covered by the appraisal statute, and may not generally replace the old ‘Delaware block’ method.

Certain courts have also equitably extended appraisal rights, and shareholder voting rights analogous to those protections available in typical merger transactions, to transactions that in substance (but not in form) are recharacterized by the courts as mergers (in other words, a de facto merger).

Another difficult question that arises in appraisal proceedings is whether the statutory appraisal remedies are the exclusive remedies available to dissenting shareholders. Depending on the wording of a state’s corporation code and relevant judicial decisions, the question may arise whether a shareholder may seek other remedies, such as enjoining the transaction when, for example, fraud, overreaching, or substantial unfair-

Certain state corporation statutes expressly provide that the right to dissent and to seek appraisal is the exclusive remedy for dissenting shareholders. Absent such language, however, the case law on the subject is divided. In all events, it appears reasonably clear that a dissenting shareholder may attack a fundamental change if it is not authorized by an applicable statute, if it has not been effected according to the proper procedures, or if it is the result of actual or constructive fraud in obtaining shareholder approval. Generally, though, if the shareholder complains simply that the transaction or price is 'unfair,' the appraisal remedy most often will be the exclusive remedy.\(^9\)

**Fiduciary Standards.** In acquisition transactions, fiduciary concerns ordinarily are generally not of major import, since the transactions are most often arm's length, negotiated events not creating any fiduciary duty. Particularly in a two-step transaction, however, when minority shareholders are included, consideration must be given to whether the majority shareholder is breaching a fiduciary duty in situations such as a freeze-out of the minority shareholders through a cash-out merger.\(^9\) Fiduciary concerns also arise in the sale by a majority shareholder of his ownership interest for a premium over what the other shareholders receive. The primary argument in this 'sale of control' issue is that the premium being paid for control is viewed as a corporate asset and not a shareholder asset and, therefore, all shareholders should have an opportunity to receive the same deal that the majority shareholders have.\(^9\) This view, however, remains in the minority. The majority take the position that in most instances there is a value to control that can be sold legitimately by a controlling person.\(^9\) In these situations, however, care must be taken to ensure that the transaction is structured in such a manner as not to give rise to a cause of action for a breach of fiduciary duty.\(^9\)


92. Cf. Model Business Corp. Act § 80(b) (1969 & Supp. 1977) (provides that there be no other remedy except as available under this section).

93. See Brockmeyer & Yerkes, Two-Step Acquisitions—"Freezing Out" Minority Shareholders, in Business Acquisitions, supra note 7, ch. 19.


96. For further discussion see O'Neal, supra note 73, ch. 4.
D. Finder’s Arrangements

Often in a corporate acquisition or combination, there will be a ‘finder,’ that is, an intermediary who brings together the parties for the purpose of effecting the transaction. The finder may be an individual, investment banker, accounting firm, bank, law firm, or other organization. On a purely technical level, a finder is often limited to introducing the prospective purchaser and seller, while a finder-broker will also participate in the actual negotiations. In fact, various investment banking houses may actually play a significant role in the actual structuring of the transaction.  

For the services performed, a finder or finder-broker will be entitled lawfully to some form of compensation. Unless the nature and extent of the compensation is determined at an early state of the transaction, determining the amount of the finder’s fee and who is responsible for paying it may become a serious obstacle to the consummation of the transaction. Far too often, an unknown finder will ‘come out of the woodwork’ at the ‘eleventh hour’ of an acquisition.

In a typical finder situation, the compensation will be paid if and when the transaction closes. In a smaller acquisition, the fee may be a flat five or six percent. If the finder-broker expends a considerable amount of time in the negotiation of the transaction, it may be as high as ten percent. In a larger deal, however, a finder’s fee may be one percent or less.

For both the purchasing corporation and the selling corporation, it is important that any finder be identified at the earliest stages and that a written contract for his services be obtained. The acquisition contract between the purchaser and seller should identify who is responsible for payment of any finder’s fees. Also, it is usual in the acquisition agreement to have indemnification provisions concerning any unknown finders’ or brokers’ fees.

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97. See generally Herz, Business Brokers’ and Finders’ Agreements, in BUSINESS ACQUISITIONS, supra note 7, ch. 3.
99. For example, a finder could threaten litigation that might impair the acquisition or at least the transfer of certain assets. At minimum, some form of holdback provision might be insisted upon by the purchaser pending resolution of the problem.
100. In large transactions, a common formula is the so-called ‘Lehman formula’ or the ‘five-four-three-two-one formula,’ pursuant to which five percent is paid on the first one million dollars, four percent on the next one million dollars, three percent on the next one million dollars, two percent on the next one million dollars, and one percent on any amounts in excess of four million dollars.
101. A typical acquisition agreement would have both parties representing and warranting concerning no finders, and these provisions would be tied into an indemnification provision. For a form of separate agreement with a finder, see Lewis, An Agreement With a
IV. TAX AND ACCOUNTING ASPECTS

A. In General

Disposition or transfer of business property will generally result in a 'taxable event' whereby any 'gain' or 'loss' resulting from the transaction will be recognized under the Internal Revenue Code (I.R.C.), Treasury Department Regulations, and Internal Revenue Service rulings. This is true unless there exist specific provisions under the I.R.C. providing otherwise. One group of I.R.C. provisions provides a means to effect tax-free "corporate reorganizations."

In common lawyer parlance, the term 'corporate reorganization' will generally evince thoughts of a corporate bankruptcy. The term used under the I.R.C., however, is much broader and includes mergers, consolidations, recapitalizations, stock acquisitions, asset acquisitions, and even changes in form or place of organization. If these transactions are effected in strict compliance with the other relevant I.R.C. provisions, then they can be consummated 'tax-free.' Many corporate combinations are structured around these tax-free reorganization provisions of the I.R.C.

The rationale behind the tax-free reorganization provisions is "that the new property is substantially a continuation of the old investment still unliquidated; and, in the case of reorganizations, that the new enterprise, the new corporate structure and the new property are substantially continuations of the old, still unliquidated." This approach is largely formalistic in many corporate combination situations, since there is often a very substantial readjustment in the investment and not simply a mechanical continuity of investment. Notwithstanding the economic realities, the I.R.C. will permit tax-free treatment if its formal requirements are met.

The three primary forms of tax-free corporate reorganizations bear the colloquial designations 'A,' 'B,' or 'C' reorganizations, since these are the

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105. For example, all of the tax-free provisions require extensive use of stock as the consideration. In such situations, the acquiring corporation (particularly if it thinks its stock is undervalued) may not wish to part with its stock; on the other hand, one or more of the sellers may wish cash, which may preclude tax-free treatment. For further discussion, see W. Painter, Corporate and Tax Aspects of Closely-Held Corporations § 8.5 (2d ed. 1981 & Supp. 1984).
107. For further discussion, see B. Bittker & J. Eustice, supra note 9, ¶ 1401.
relevant subsections of the I.R.C. provisions.\textsuperscript{108} Under the I.R.C., these basic forms of corporate reorganization are:

(A) A statutory merger or consolidation;\textsuperscript{109}

(B) The acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);\textsuperscript{110} and

(C) The acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation) of substantially all of the property of another corporation, but in determining whether the exchange is solely for stock, the assumption by the acquiring corporation of the liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded.\textsuperscript{111}

In relating the tax status of these reorganizations to the different types of corporate acquisition situations discussed above, one can see that the ‘A’ reorganization is a statutory merger or consolidation, the ‘B’ reorganization is the stock exchange, and the ‘C’ reorganization is the sale of substantially all of the assets. The major qualifications are that all of these transactions must have a significant use of stock as consideration, and they must also comply with ‘judicial gloss’ and highly complex Treasury Regulations and Internal Revenue Service rulings.

\section*{B. The Judicial Gloss}

The corporate reorganization provisions of the I.R.C. have been subject to significant judicial interpretation, which has resulted in the formulation of ‘judicial gloss’ that must be taken into consideration when interpreting the basic statutory provisions. The judicial gloss includes such doctrines as “business purpose,” “continuity of business enterprise,” “continuity of proprietary interests,” and “step transaction.”\textsuperscript{112}

\textbf{Business Purpose.} This judicial doctrine is derived from the United

\begin{itemize}
  \item [\textsuperscript{108}] I.R.C. § 368(a)(1) (1984). Section 368(a)(1) also provides for other types of tax-free reorganizations, such as the ‘D’ reorganization respecting transfer of assets to controlled corporations, the ‘E’ reorganization concerning recapitalizations, and the ‘F’ reorganization regarding changes in identity, form or place of organization.
  \item [\textsuperscript{110}] Id. § 368(a)(1)(B).
  \item [\textsuperscript{111}] Id. § 368(a)(1)(C).
  \item [\textsuperscript{112}] See generally B. Bittker \& J. Eustice, supra note 9, ¶ 14.51.
\end{itemize}
States Supreme Court decision in *Gregory v. Helvering*,\(^{113}\) which upheld Judge Learned Hand's decision in *Helvering v. Gregory*.\(^{114}\) In *Gregory*, the taxpayer had carefully structured, in full compliance with the I.R.C. reorganization and liquidation provisions, a complicated *spinoff* and liquidation transaction. In noting that "[a]nyone may so arrange his affairs that his taxes shall be as low as possible,"\(^{115}\) Judge Hand stated:

Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition. It is quite true, as the [Board of Tax Appeal] has very well said, that as the articulation of a statute increases, the room for interpretation must contract; but the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create. The purpose of the section is plain enough; men engaged in enterprises—industrial, commercial, financial, or any others—might wish to consolidate, or divide, or add to, or subtract from, their holdings. Such transactions were not to be considered as "realizing" any profit, because the collective interest still remained in solution. But the underlying presupposition is plain that the readjustments shall be undertaken for reasons germane to the conduct of the venture in hand, not as an ephemeral incident, egregious to its prosecution. To dodge the shareholders' taxes is not one of the transactions contemplated as corporate "reorganizations."\(^{116}\)

In upholding Judge Hand's recharacterization of the transaction, the United States Supreme Court emphasized that: "An operation having no business or corporate purpose—a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was a consummation of a preconceived plan" will not qualify the transaction for treatment as a tax-free reorganization, irrespective of its formal compliance with the relevant I.R.C. provisions.\(^{117}\) As noted by Bittker and Eustice:

Although *Gregory* may mean all things to all men, its essence is an instinctive judicial attitude that a transaction should not be given effect for tax purposes unless it serves a purpose other than tax avoidance. A transaction heavily laden with tax avoidance motives may be disregarded as a "sham", or its form may be recast so as to reflect its economic "substance", or interdependent steps in a "single transaction" may be col-

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\(^{113}\) 293 U.S. 465 (1935).

\(^{114}\) 69 F.2d 809 (2d Cir. 1934).

\(^{115}\) Id. at 810.

\(^{116}\) Id. at 810-11.

\(^{117}\) 293 U.S. at 469-70.
lapsed in order to prevent overreaching taxpayers from doing indirectly what they cannot do directly. As elsewhere in the law of taxation, the lawyer's passion for technical analysis of the statutory language should always be diluted by distrust of a result that is too good to be true.118

Under Treasury Regulations,119 the focal point is on a reasonable corporate business purpose, as distinguished from a legitimate shareholder purpose. This distinction becomes particularly troublesome in the situation of closely-held corporations. In Lewis v. Commissioner,120 however, the circuit court rejected such a distinction.121 To be a legitimate shareholder purpose, however, that purpose probably must achieve more than a particular tax result.

**Continuity of Business Enterprise.** In December 1980, the Treasury adopted a new regulation concerning the judicially developed doctrine of "continuity of business enterprise."122 Essentially, the new regulation requires that the transferee corporation (i) continue the transferor's "historic business" or (ii) continue to use a "significant portion" of the transferor's "historic business assets" in a business.123

The new regulation puts forth a number of examples.124 Example (1) makes clear that the transferee need only continue one line of business, although the transferor may have several lines of business. Examples in which the doctrine would not be satisfied are: when the transferee sold its operating assets and became an investment company three and one-half years prior to the purported reorganization; when the transferee acquired the transferor after the latter had sold its operating assets for cash and notes; or when the transferee sold off the transferor's assets after the acquisition and discontinued that line of business.

The new Treasury regulation, however, is only expressly applicable to 'asset transfers.' The question can be raised, therefore, whether the doctrine is any longer applicable to the 'B' (stock-for-stock) reorganization. The prior court decisions would probably be looked to in such situations, although most of these decisions also involve the transfer of assets.125

**Continuity of Proprietary Interests.** The courts and Treasury

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119. Treas. Reg. §§ 1.368-1(b), 1.368-1(c) & 1.368-2(g).
120. 176 F.2d 646 (1st Cir. 1949). See also Laure v. Commissioner, 653 F.2d 253 (6th Cir. 1981). For further discussion of the roots of the doctrine, see Bittker, What is "Business Purpose" in Reorganizations?, 8 N.Y.U. INST. ON FED. TAX. 134 (1950).
121. 176 F.2d at 649.
122. Treas. Reg. § 1.368-1(d).
123. Id.
124. See id. § 1.368-1(d)(5).
125. For further discussion of this regulation, see Bloom, Resurrection of a Dormant Doctrine: Continuity of Business Enterprise, 7 J. CORP. TAX'N 315 (1981).
regulations both require that the original owners of the acquired corporation retain a continuing interest in the reorganized corporation. In terms of continuity, therefore, the courts and the Internal Revenue Service focus not only on the corporate but also on the shareholder level. Such continuity appears to require some continuing equity interest, rather than a mere creditor position.127

This doctrine involves a number of complex considerations, including the type of consideration that will satisfy the continuity requirement. Voting stock is not necessarily required, but some form of equity stock appears to be essential. The permissible proportion of equity and non-equity consideration is also unclear. For purposes of granting rulings, the Internal Revenue Service requires a fifty percent equity consideration, even if not on a pro rata basis. Another difficult area is the percentage of former owners who must have a continuing proprietary interest in the reorganized corporation. The fact that some shareholders in a merger or consolidation are cashed out will not, in and of itself, taint the tax-free status of the transaction for the other shareholders.129

Step Transaction Doctrine. This judicial doctrine is basically an extension of the judicial technique of looking at substance over form. For example, in many acquisition situations, a number of steps appear to be separate. Whether the court looks at each step separately or integrates all the steps can affect the legal consequences of the transaction. The ‘step transaction’ doctrine is always an overriding consideration in structuring most sophisticated business transactions.130

C. The ‘A’ Reorganization (Merger or Consolidation)

The reorganization provisions of the I.R.C. do not define what constitutes a statutory ‘merger or consolidation’ for the purpose of qualifying as a tax-free reorganization. A Treasury regulation requires that a corporate combination be “effected pursuant to the corporation laws of the United States or a state or territory or the District of Columbia.”131 Thus, the

129. See Painter, supra note 105, at 436.
I.R.C. and the regulation defer to compliance with state corporate law requirements. The 'A' reorganization is, therefore, generally the easiest to comply with for tax purposes since various forms of consideration may be given in a merger or consolidation; it also provides one of the more flexible forms of tax-free reorganization.132

It must be remembered, however, that the various judicial doctrines of continuity of proprietary interest, continuity of business enterprise, and business purpose place some constraints upon the 'A' reorganization. If these requirements are satisfied, however, nonvoting stock may be used as consideration, and payment of various acquisition expenses will not taint the transaction. It should be noted that if a shareholder does receive 'boot,' nonstock consideration for his interest, he will be taxable to the extent of such 'boot.' Yet, the receipt of 'boot' by an individual in a merger or consolidation does not affect the overall tax status of the transaction for the other shareholders who receive some form of stock, unless there is no continuity of business and propriety interests.133

D. The 'B' Reorganization (Stock-For-Stock Acquisition)

Although we have seen that, from a corporate point of view, the stock exchange is a relatively simple transaction that generally requires no shareholder approval and provides for no appraisal rights, this form of transaction may become very complex in order to satisfy the tax-free reorganization requirements of the I.R.C. In particular, the requirement that the exchange be "solely" for all or a part of the "voting" stock of the acquiring corporation, or the "voting" stock of the parent entity, often poses considerable problems.134

To qualify for tax-free treatment in a 'B' reorganization, it is essential that all of the consideration be voting stock. Bonds, notes, warrants, options, or convertible debentures are, therefore, excluded.135 The only real flexibility here is lack of any requirement that the acquiring company must issue stock with precisely the same voting power as its other outstanding shares. The acquiring corporation is free to create a new class of common stock with voting rights, even though these voting rights are less than those of its other outstanding common stock.136

The prohibition against providing cash to any shareholder is often a major obstacle in effecting this transaction. Sometimes this problem can

133. See B. Bittker & J. Eustice, supra note 9, ¶ 14.12.
134. Id. ¶ 14.13.
be averted by having the acquired corporation redeem beforehand the shares of shareholders who desire cash from legally available funds, or by having a group of shareholders first purchase the stock of those shareholders.\textsuperscript{137} Another problem arises when the acquiring corporation wishes to enter into employment agreements with shareholders of the acquired corporation. If such arrangements are deemed as additional compensation for the shares and not justifiable compensation for services, then this nonstock consideration could taint the entire transaction for all parties.\textsuperscript{138}

Another requirement of the 'B' reorganization is that, immediately after the acquisition, the acquiring corporation must have control of the acquired corporation. For Internal Revenue Service purposes, control is designated as ownership of at least eighty percent of the voting stock of the acquired corporation.\textsuperscript{139}

The Internal Revenue Service seems to permit an acquiring corporation to pay the expenses of registering its own shares with the Securities and Exchange Commission.\textsuperscript{140} Other expenses, however, including attorneys' and accountants' fees, must be paid by the shareholders.\textsuperscript{141}

The 'B' reorganization is susceptible to the step transaction doctrine. Sometimes, the main stock-for-stock exchange transaction may be preceded by a series of open market or private purchases of stock including cash as consideration and may be followed by a cash-out merger. An integration of these steps could eliminate the availability of tax-free treatment for the transaction.\textsuperscript{142}

E. The 'C' Reorganization (Stock-for-Assets Acquisition)

Under the 'C' reorganization, substantially all of the assets of the acquired corporation must be transferred 'solely' in exchange for voting stock of the acquiring corporation or its parent. The Code, however, expressly permits the acquiring corporation to assume the liabilities of the acquired corporation and to acquire property subject to liabilities.\textsuperscript{143}

In determining what constitutes 'substantially all the properties,' for ruling purposes, the Revenue Service uses seventy percent of gross assets and ninety percent of net assets as threshold figures.\textsuperscript{144} It does not seem that any particular percentages are entirely relevant, however. The

\textsuperscript{137} See Miller, Redemptions Prior to B Reorganizations May Permit Shareholders to Pull Out Cash, 49 J. Tax'n 354 (1978).
\textsuperscript{141} See B. Brtikker & J. Eustice, supra note 9, ¶ 14.13.
\textsuperscript{142} See supra section IV(B).
\textsuperscript{144} Rev. Proc. 79-14, 1979-1 C.B. 496.
The sounder view is that one looks to the nature of the properties retained by the transferee, the purposes of the retention, and the amount thereof.\footnote{145} The consideration that must be paid in a 'C' reorganization is usually the voting stock of the acquiring corporation or its parent, but there are certain limited exceptions to this rule. As mentioned above, the acquiring company can assume the liabilities of the acquired entity by acquisition of properties subject to liabilities. Pursuant to the I.R.C., a small amount of cash or other nonstock consideration may also be given, if at least eighty percent of the fair market value of all property of the transferor corporation is acquired for voting stock.\footnote{146} Up to twenty percent of the property, by fair market value estimates, can be acquired for cash. Application of this exception can be very difficult, and a miscalculation can prove fatal to the desired tax objectives.\footnote{147} Under recent statutory changes the transferring corporation in a ‘C’ reorganization must be liquidated.\footnote{148}

\section*{F. The Triangular Mergers (‘Forward’ and ‘Reverse’) }

The corporation codes of most states permit a controlled subsidiary to effect a ‘triangular’ merger with another corporation through the use of the subsidiary parent’s stock. The parent will often establish the subsidiary for the sole purpose of effecting the corporate combination. The parent will drop down into the subsidiary sufficient shares of its stock to serve as consideration for the merger. If the acquired corporation merges into the subsidiary, this is considered a forward triangular merger. If the subsidiary merges into the acquired corporation, this is considered a reverse triangular merger. Triangular mergers are sometimes effected in order to achieve a subsidiary wholly owned by the parent. The subsidiary is used to isolate liabilities or circumvent certain restrictions on the acquired corporation.\footnote{149}

The Internal Revenue Service did not recognize the parent in a triangular merger as a party to the reorganization prior to 1968. The stock of the parent, therefore, constituted taxable ‘boot’ in most instances. In 1968, however, Congress amended the definition of a reorganization under I.R.C. section 368(a)(2)(D) to permit a forward triangular merger involving controlled subsidiaries.\footnote{150}
Congress also enacted a new Code provision regarding forward triangular mergers. The provision permits the triangular merger to be treated as an ‘A’ reorganization if: (i) “substantially all” the properties of the acquired entity are acquired by the subsidiary; (ii) the acquired entity is merged into the subsidiary; (iii) the merger would have qualified under the I.R.C. as an ‘A’ reorganization had it been effected directly into the parent; and (iv) no stock of the subsidiary is used in the transaction.\textsuperscript{151}

Congress addressed the issue of reverse triangular mergers in 1971,\textsuperscript{152} when the Revenue Service characterized such transactions as the functional equivalents of ‘B’ reorganizations. This characterization required that the transactions be effected exclusively with the voting stock of the acquiring corporation’s parent. A reverse triangular merger can now qualify, however, as an ‘A’ reorganization if the surviving corporation holds ‘substantially all’ of the properties of both corporations after the transaction, and the former shareholders in the surviving corporation exchange stock constituting ‘control,’ eighty percent or more, for voting stock of the parent. A small amount of consideration other than voting stock, therefore, will not destroy the tax-free status.\textsuperscript{153}

G. Other Tax Concerns

The question of tax-free status is not the only concern in an acquisition situation. Numerous concerns also exist in a taxable situation with respect to whether there is any gain to be recognized from the transaction. Some of these concerns are the characterization of any such gain as capital gain or a “dividend equivalent”\textsuperscript{154} and the timing of the reporting of the gain as installment sales.\textsuperscript{155} Another major concern arises when an acquisition is being effected in order to take advantage of the acquired corporation’s net operating loss.\textsuperscript{156} Extensive tax regulations and rulings
govern whether a corporation's net operating loss is available to the surviving corporation in an acquisition situation. Significant planning is necessary in structuring this transaction to ensure the desired result.157 Sophisticated problems also arise in transferring the other 'tax attributes' of the acquired corporation to the acquiring corporation, and in complying with requirements for subsequently reporting the income of an acquired subsidiary on a "consolidated" tax basis.158

H. Accounting Aspects

The accounting treatment of corporate combinations weighs heavily in structuring these transactions. The two basic techniques used in accounting for corporate combinations are pooling of interests and purchase with a subsequent disposition of good will.159

Tax Methods. The pooling of interests method is derived from treating the transaction as a corporate combination rather than as a purchase of one corporation by another. The assets and liabilities of the acquiring and acquired corporation are pooled, and the assets of the acquired corporation are carried on the books of the acquiring corporation at book value rather than at market value. The earned surplus accounts of both corporations are also aggregated.160

Under the purchase method, assets of the acquired corporation are carried on the books of the acquiring corporation at cost, determined by the fair market value of the consideration paid. If the assets are acquired for a price greater than the amount carried on the books of the acquired company, the value of the acquired corporation's assets will usually be written up to an amount approximating the fair market value at the time of acquisition. Any amounts in excess of a defensible fair market value will be carried on the books of the acquiring company as goodwill. Goodwill is an intangible asset reflecting the excess of the parent's investment in the acquired corporation over the fair market value of the acquired corporation's assets, less any liability assumed.161

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157. See Sinrich, Tax Consequences of Acquisitions Involving Net Operating Loss Carryovers, in BUSINESS ACQUISITIONS, supra note 7, ch. 16.
160. Id. ¶¶ 53-56. See also S. SIEGEL & D. SIEGEL, ACCOUNTING AND FINANCIAL DISCLOSURE ch. 13 (1984).
Each of the accounting methods discussed above are acceptable means of recording business combinations, although the pooling of interests method is usually the desired method. The pooling of interests method is, however, subject to very specific and distinct criteria, all of which must be met for the transaction to be so recorded. If all of the conditions are not met, then the transaction must be recorded as a purchase. Certain of the more significant general requirements for a ‘pooling’ are:

(i) The transaction must involve totally independent entities (with no more than ten percent inter-company investment in common stock prior to initiation of plan of acquisition);

(ii) the transaction must be effected through an exchange of existing voting common stock, with the acquiring corporation receiving at least ninety percent of the voting common stock of the acquired entity; and

(iii) the acquisition must be effected in a single transaction or within one year according to a plan. In a merger solely for voting stock, these ‘pooling’ requirements are usually easy to satisfy. Tender offers, stock acquisitions using nonvoting stock, and creeping acquisitions, however, will usually be treated as purchases.

Impact of Choice of Method. The choice of accounting methods can have a significant impact upon the financial condition of the surviving entity as reflected on its books and on the future earnings of the newly combined enterprise. The ‘pooling method’ is generally the more desirable method providing its strict requirements can be met. The following example illustrates the divergent results arising from these different accounting methods.

Example (Merger by Voting Stock)

On December 31, 1984, “A” Corporation acquires all the assets and liabilities of “B” Corporation through a statutory merger. The purchase price is $10,000,000, effected through “A”’s issuance of 2,000,000 shares of its voting common stock, $1 par value, having a trading market value of $5 per share.


163. For further discussion, see Fiflis, Accounting for Merger, Acquisitions and Investments in a Nutshell The Interrelationships of, and Criteria for, Purchase or Pooling, The Equity Method, and Parent-Company-Only and Consolidated Statements, 37 Bus. Law. 89 (1981).

164. For further examples, see T. Fiflis & H. Kriebke, Accounting for Business Lawyers 605-22 (2d ed. 1977).
BEFORE ACQUISITION

“B” Corporation
Balance Sheet Items
(December 31, 1984)

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Accounts Receivables</td>
<td>3,000,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>4,000,000</td>
</tr>
<tr>
<td>Fixed Assets*</td>
<td>1,000,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$10,000,000</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders’ Equity (Net Worth)</td>
<td></td>
</tr>
<tr>
<td>Capital Stock</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>4,000,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>$10,000,000</strong></td>
</tr>
</tbody>
</table>

*The fixed assets consist of real property and fixtures having a 15-year remaining life with a book value of $1,000,000, but with a fair market value of $3,000,000.

“A” Corporation
Balance Sheet Items
(December 31, 1984)

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>15,000,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>20,000,000</td>
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<tr>
<td>Fixed Assets</td>
<td>15,000,000</td>
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<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$60,000,000</strong></td>
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</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders’ Equity (Net Worth)</td>
<td></td>
</tr>
<tr>
<td>Capital Stock</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>20,000,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>$60,000,000</strong></td>
</tr>
</tbody>
</table>
**AFTER ACQUISITION (POOLING METHOD)**

"A" Corporation  
Balance Sheet Items  

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>12,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>18,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>24,000,000</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>16,000,000</td>
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<table>
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<th>Liabilities</th>
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<th>Shareholders’ Equity (Net Worth)</th>
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<tr>
<td>Capital Stock</td>
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</tr>
<tr>
<td>Retained Earnings</td>
<td>24,000,000</td>
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</tr>
</tbody>
</table>

$70,000,000

*Under the “pooling” method the results of the entities are combined as if there were no purchase.

**AFTER ACQUISITION (PURCHASE METHOD)**

"A" Corporation  
Balance Sheet Items  

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$12,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>18,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>24,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>18,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Good Will</td>
<td>3,000,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Shareholders’ Equity (Net Worth)</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Stock</td>
<td>12,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital in excess of par</td>
<td>8,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>20,000,000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

$75,000,000

*Under the “Purchase” method, retained earnings are not aggregated. The purchase price is allocated to the fair market value of assets. As such, the fixed assets of "B" Corporation will be carried over at the increased fair market value, with the $3,000,000 excess of the purchase price attributed to goodwill. Goodwill in turn will have to be amortized over a period not in excess of 40 years (thus creating a non-tax deductible annual amortization of $75,000). In addition, the write-up of "B"'s fixed assets will increase depreciation expenses. Thus, while the purchase method may reflect an increase in net worth at the date of the acquisition, the greater amortization and depreciation expenses will adversely impact "A"'s income statement for the 1983 period and subsequent periods.
Corporate combinations can entail numerous federal law considerations other than those of federal tax. Of particular note are the federal securities and antitrust laws. Other federal laws such as labor laws, environmental laws, health and safety laws, and ERISA (particularly regarding the transfer of any liabilities under employee benefit plans) may also bear heavily upon an acquisition transaction. State securities, takeover, antitrust, bulk sales under the U.C.C., and insurance laws involving transfer of insurance policies or the attainment of new policies may also be included. This section will touch upon the federal securities laws and will briefly consider antitrust law considerations. Treatment of these two bodies of federal law can only be summary in nature.

A. Federal Securities Law

Offer or Sale of a Security: Registration. A stock-for-stock exchange has traditionally been treated as a sale for the purpose of determining the applicability of the registration requirements under the Federal Securities Act of 1933. Until 1972, statutory mergers or consolidations and sales of substantially all assets for stock were not considered as including a "sale" of a security under old SEC Rule 133. The SEC rescinded Rule 133 and promulgated in its place Rule 145 effective January 1, 1973. Under Rule 145 the SEC negated its prior position and ruled that the issuance of a security in a merger or consolidation or purchase of assets was to be treated as a sale of a security for purposes of the 1933 Act. This sale will, therefore, come under the registration requirements of the 1933 Act.

An offer or sale under Rule 145, for purposes of the 1933 Act, is seen as having taken place at the time that the acquisition plan is submitted to the shareholders of the acquired corporation for their consideration and approval. If a public corporation is included, then shareholder approval will include the solicitation of proxies pursuant to section 14 of the Securities Exchange Act of 1934. In such situations, the solicitation...
materials sent to the shareholders would constitute both a prospectus under the 1933 Act and proxy materials under the 1934 Act. To simplify and reduce the burdens that this dual disclosure would entail, the SEC has established under Rule 145 a specific, integrated disclosure Registration Form S-14 which covers these situations.  

**Exemption Requirements.** SEC Rule 145 does not alter the availability of a statutory or regulatory exemption from registration that would otherwise be available. The basic dictate of the 1933 Act is that every offer or sale of a security must meet the registration requirements of the 1933 Act unless an exemption can be proven.  

The statutory transactional exemptions from the registration requirements of the 1933 Act usually relied upon are: (i) the private placement exemption under Section 4(2) of the 1933 Act; (ii) the intrastate offering exemption under Section 3(a)(11) of the 1933 Act and (iii) the limited $5,000,000 offering exemption respecting accredited investors under Section 4(6) of the 1933 Act. The SEC has also adopted a number of significant exemptions rules: Rule 147 concerning the intrastate offering; Regulation A under Section 3(b) concerning limited ($1,500,000) offerings; and most recently, Regulation D under Sections 3(b) and 4(2) of the 1933 Act concerning limited and nonpublic offerings.  

It should be noted, however, that all exemptions under the 1933 Act are merely exemptions from the registration requirements of the 1933 Act. They are not exemptions from liability or certain reporting requirements under the securities laws. Moreover, the burden of proof in establishing

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the existence of an exemption always rests on the claimant. Due to the dual system of federal and state securities laws, one must also look to the specific requirements of the relevant 'blue sky' laws for exemption from the registration requirements of relevant state securities laws.

**Proxy Regulations.** If one or more parties to an acquisition is a 'public corporation,' its federal proxy regulations may be applicable. Regardless of whether securities constitute part of the consideration to effect a corporate combination, public corporations, those subject to the continuous reporting requirements of the 1934 Act, must comply with the SEC's proxy regulations. Soliciting proxies in an acquisition in which one of the soliciting parties is a public corporation, without compliance with the relevant SEC proxy regulations, is prohibited.

The primary SEC proxy regulation is Regulation 14A, which provides in part: "No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A." The proxy regulations are designed to provide each shareholder with all material information necessary to make an informed decision concerning the matters being presented for consideration at the shareholders' meeting. In the case of mergers, consolidations, acquisitions, or similar matters, Item 14 of Schedule 14A contains extensive descriptive and financial information that must be disclosed concerning the acquisition transaction itself. Other items of Schedule 14A also require significant information about the nature of the company, its operations, and management.

The standard of materiality applied to the proxy disclosures is a general one:

An admitted fact is material if there is a substantial likelihood that a
reasonable shareholder would consider it important in deciding how to vote... It does not require proof of a substantial likelihood that disclosure of the admitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is the showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.187

Failure to comply with the materiality requirement could lead to a private or administrative suit under SEC rule 14a-9.188 If a purchase or sale of securities is involved in the transaction, private or administrative action could also be brought under the general anti-fraud provisions of section 10(b) of the 1934 Act, and SEC Rule 10b-5.189 When securities are not the consideration in a corporate acquisition, but both the acquiring and the acquired corporations are 'public' corporations, then a 'joint' proxy statement is usually filed if a shareholder vote of the acquiring corporation is required.190

Other Disclosure Requirements. In addition to any registration or proxy disclosure requirements in an acquisition situation, if a public corporation is included, it must comply with additional reporting requirements under SEC Rule 13a191 and will be required to file a Current Report on Form 8-K.192 Furthermore, if the securities of an involved corporation are listed on a stock exchange, then the corporation may also be subject to timely disclosure requirements of that stock exchange.193

Another important area of disclosure comes under the tender offer requirements of the 1934 Act.194 These statutory tender offer provisions are referred to as the Williams Act amendments.195 These provisions embrace

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190. See SEC Registration Form on S-14.
192. The other reports under section 13 comprise annual (Form 10-K) and quarterly (Form 10-Q) disclosures.
194. On background to the federal tender offer laws, see E. Aranow & H. Einhorn, Tender Offers for Corporate Control (1972); see also analysis by Bromberg, Tender Offers: Safeguards and Restraints—An Interest Analysis, 23 CASE W. RES. 613 (1970).
195. See Pub. L. No. 90-439, 82 Stat. 454 (1968). This Act added Sections 13(d), (e) and
both cash tender offers and stock-for-stock exchange offers.\(^\text{196}\)

Under the 1934 Act,\(^\text{197}\) any person who, after acquiring beneficial ownership of an equity security registered under the 1934 Act, owns five percent or more of that class must make formal disclosure of such ownership on a Schedule 13D. This disclosure is made to the issuer of the security, to any stock exchange on which the security is traded, and to the SEC within ten days after the acquisition. The Schedule 13D must disclose not only background information identifying the beneficial owners and all other persons on whose behalf the person has made purchases, but also the source and amount of funds expended, whether or not the purpose of the acquisition is to acquire control. Any plans the person may have to liquidate, merge, or effect any other major change in the issuer; the aggregate number and percentage of the securities classes owned by the reporting person; and information concerning any arrangement for the transfer of any securities of the issuer must also be disclosed by the Schedule 13D. The beneficial owner is under a continuing duty to amend Schedule 13D whenever a material change occurs in the facts reported.\(^\text{198}\) General partnerships, limited partnerships, syndicates, and other groups acting together for the purpose of acquiring, holding, or disposing of securities of an issuer are deemed to be 'persons' for purposes of determining whether they are the owners of five percent or more of the class of equity security.\(^\text{199}\)

The 1934 Act directly addresses the tender offer, whether for cash or for securities, by making it unlawful for any person to make a tender offer for a registered class of equity securities unless a Schedule 14D-1 is filed with the SEC.\(^\text{200}\) The SEC has also adopted a series of rules concerning conduct during a tender offer and the 1934 Act contains a broad anti-fraud provision.\(^\text{201}\) This provision makes it unlawful for any person to make any untrue statement of a material fact; to omit any material fact necessary to make the statement not misleading in the circumstances under which it is made; to engage in any fraudulent, deceptive, or manipulative acts or practices in connection with any tender offer, request, or invitation of tenders; or to solicit security holders in opposition to, or in

\(^{14(d), (e)\text{ and (f) to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m(d), (e), 78m(d),}}\)196. See Loss, supra note 170, ch. 7(E).


favor of, any such offer, request, or invitation.\textsuperscript{202} This provision is applicable to any tender offer, regardless of whether it is an offer of a security, or whether the securities are equity, or whether they are registered.

There are a number of other SEC rules and provisions of the 1934 Act that may have impact upon the conduct of a tender offer. For example, the 1934 Act requires a formal filing with the SEC and notice to all voting security holders respecting material information in a proxy statement whenever a majority of the directors is chosen outside of a formal stockholders' meeting pursuant to any agreement with the person acquiring shares in a tender offer or a transaction which must be reported under section 13d of the 1934 Act.\textsuperscript{203}

The SEC, pursuant to its rule-making authority, also prohibits a person from tendering shares, by borrowing or otherwise, that he does not own.\textsuperscript{204} Additionally, the SEC prohibits purchases, directly or indirectly, of any shares of the target company except pursuant to the tender offer once a tender offer has been made, although this prohibition is subject to certain limited exceptions.\textsuperscript{205}

Questions have arisen concerning whether the state tender offer statutes are preempted by the federal statutes.\textsuperscript{206} In a recent decision,\textsuperscript{207} the Supreme Court invalidated the Illinois takeover statute. This decision, which was based in part upon the burden on interstate commerce, makes the continuing viability of state takeover statutes doubtful. It may be possible, however, that a particular state takeover statute can be structured so that it does not constitute a direct restraint on interstate commerce.\textsuperscript{208}

**Other Provisions.** Other provisions of the federal securities laws and regulations that may have impact upon an acquisition situation include:

(i) **Rule 10b-6**—This rule prohibits issuers, underwriters, and others who make or participate in a 'distribution,' directly or indirectly, from bidding for, purchasing, or inducing others to bid for or purchase, a security that is subject to the distribution, or "any right to purchase" that security.\textsuperscript{209}

(ii) **SEC Rule 10b-5**—This rule is a general securities anti-fraud provision that has been used to place restraints on insider trading before the public announcement of material information which may be involved

\begin{itemize}
\item \textsuperscript{203} See id., 15 U.S.C. § 78n(f) (1934).
\item \textsuperscript{204} See id., 17 C.F.R. § 240.10b-4(a)(1) (1968).
\item \textsuperscript{205} See id., 17 C.F.R. § 240.10b-13 (1969).
\item \textsuperscript{206} For further discussion of state tender offer statutes, see Langevoort, State Tender-Offe r Legislation: Interests, Effects and Political Competency, 62 CORNELL L. REV. 213 (1977).
\item \textsuperscript{207} Edgar v. Mite Corp., 457 U.S. 624 (1982).
\item \textsuperscript{208} See comment on the Mite case, in Loss, supra note 170, at 601-03.
\item \textsuperscript{209} See Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-6 (1934).
\end{itemize}
in a tender offer.\textsuperscript{210}(iii) \textit{Section 16(b) of the 1934 Act}—This Code section places restraints on ‘short-swing’ profits realized by an officer, director, or ten percent shareholder of a public corporation from any purchase or sale (not necessarily resulting from the same initial transaction) within any six-month period. Any profits from such transactions must be disgorged and returned to the corporation.\textsuperscript{211} The Supreme Court, however, has recently ruled that an exchange of securities in an acquisition situation is not automatically characterized as a purchase or sale subject to section 16(b).\textsuperscript{212} The Supreme Court has adopted a ‘pragmatic approach’ with respect to ‘short-swing’ liability by recognizing ‘borderline transactions’ that do not constitute an abuse contemplated by section 16(b). In effect, certain extraordinary or ‘unorthodox’ transactions (which term should be construed narrowly) may not be within the ambit of section 16(b).\textsuperscript{213}\textsuperscript{(iv) \textit{Rule 144 restrictions on resales}—Securities received in an acquisition transaction by officers, directors or other control people will be subject, even if registered, to various restraints on resale under SEC Rule 144.\textsuperscript{214} (v) \textit{Margin requirements}—If a stock acquisition is being financed, then such financing may come under the ‘margin’ requirements under the 1934 Act.\textsuperscript{215}

\textbf{B. Note on Federal Antitrust Laws}

All forms of corporate acquisitions and combinations may come within the purview of federal antitrust statutes.\textsuperscript{216} These transactions are most often challenged under section 7 of the Clayton Act. This Act addresses any corporate action, whose effect “in any line of commerce in any section of the country” may be “substantially to lessen competition, or to tend to

\textsuperscript{210} See \textit{supra} note 189. See also SEC Rel. No. 33-509 (Oct. 15, 1970); SEC v. Shapiro, 494 F.2d 1301 (2nd Cir. 1974).


\textsuperscript{212} See Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973). In \textit{Kern County}, the ‘unorthodox’ transaction involved an involuntary stock exchange by one party that found itself trapped in an unsuccessful takeover bid. In fact, this party found itself in an ‘insider’s’ position without having any real inside information; thus, the possibility of speculative abuse of information was not present in this situation.

\textsuperscript{213} For discussion of certain key issues raised by and related to \textit{Kern County} see Ribstein, \textit{The Application of Section 16(b) of the Securities Exchange Act of 1934 to Tender Offers}, 31 Sw. L.J. 503 (1977). See also Hazen, \textit{The New Pragmatism Under Section 16(b) of the Securities Exchange Act}, 54 N.C. L. Rev. 1 (1975).

\textsuperscript{214} See 17 C.F.R. § 230.144. For further discussion of Rule 144, see Loss, \textit{supra} note 170, ch. 5F(4), at 417.

\textsuperscript{215} See Federal Reserve Board of Governors, Regulations G, T, U & X in 12 C.F.R. §§ 207.220, .221, .224, respectively.

\textsuperscript{216} See generally E. Kintner, \textit{An Antitrust Primer} ch. 22 (2nd ed. 1973) for background information. For the current state of law, see J. von Kalinowski, \textit{Antitrust Laws and Trade Regulations}, vols. 16A-M (1983).
create a monopoly.\textsuperscript{217} The Cellar-Kefauver Act of 1950 amended section 7 to make clear that the prohibitions of this section are equally applicable to assets, stock acquisitions, vertical and conglomerate mergers, and to horizontal mergers.\textsuperscript{218} Corporate combinations may also be challenged under sections 1 and 2 of the Sherman Act as a restraint on trade or monopoly\textsuperscript{219} or under section 5 of the Federal Trade Commission Act\textsuperscript{220} as an unfair method of competition. Other provisions of the federal antitrust laws that may have effect upon a corporate acquisition are: Section 8 of the Clayton Act, which deals with interlocking directorates,\textsuperscript{221} and section 7A of the Clayton Act, which pertains to pre-merger notification and clearance.\textsuperscript{222} Many states also have their own antitrust laws, some of which are quite vigorous.\textsuperscript{223} These state antitrust laws are not preempted by the federal antitrust laws but co-exist with their federal counterparts.\textsuperscript{224}

VI. LEGAL ORCHESTRATION

A. Legal Review

One of the primary roles of the business lawyer in an acquisition, especially when representing a purchaser, is to conduct a thorough review of the other party to the acquisition. From the point of view of the purchaser, this legal review should be conducted simultaneously with the business and accounting reviews of the target enterprise and probably will continue throughout the entire transaction. Often a thorough legal review will not only uncover significant legal problems but will also raise serious business considerations. For example, the identification of significant litigation against the target company will entail not only a legal assessment but also an ultimate business decision concerning the risks in acquiring a corporation with such contingent liability.

A sample Acquisition Checklist is contained in Appendix 2 to this Article. This checklist indicates the types of information that a business law-

\textsuperscript{218} 64 Stat. 1125 (1950).
\textsuperscript{219} See 15 U.S.C. §§ 1, 2 (1982). Also in particular, see new U.S. Department of Justice, REvised MERger GUIDELINES (June 14, 1984); 49 TRADE REG. 26824 (June 29, 1984); (CCH) § 4490.
\textsuperscript{221} See id. § 19 (1982).
\textsuperscript{223} See, e.g., the Texas antitrust laws, largely codified in Tex. Bus. CORP. ACT § 15.01 (Vernon 19—).\textsuperscript{224} See generally W. LIFLAND, STATE ANTITRUST LAW (1984).
yer may wish to elicit in a thorough corporate review of a merger situation. The degree of risk for the acquiring corporation is greater in a merger than in the other legal forms of acquisition because in a merger, by operation of law, all assets and liabilities of the acquired corporation are merged into and become a part of the acquiring corporation. A conservative approach, however, would be to treat all forms of corporate combinations the same for purposes of legal review. For instance, in a stock exchange, although the acquiring corporation becomes a subsidiary of the parent and, therefore, its liabilities are legally isolated from the parent, a serious contingent liability that materializes in the subsidiary would affect the acquiring corporation's investment in its new subsidiary. Similar concerns may arise with respect to an asset acquisition, even though in an asset acquisition, the acquiring corporation specifies by contract the assets and liabilities it wishes to acquire.\textsuperscript{226}

B. Documentation

As previously discussed, virtually all culminations of corporate acquisitions will involve an extensive series of contractual documents. Often these documents will include:

(i) A letter of intent, which will be a nonbinding statement of the basic terms upon which the acquisition will be affected.\textsuperscript{227}

(ii) Appropriate corporate resolutions from the board of directors or shareholders of one or more of the corporations involved.\textsuperscript{227}

\textsuperscript{225} For further discussion of the practical role of the attorney in an acquisition, see B. Fox & E. Fox, \textit{supra} note 7, ch. 2.

\textsuperscript{226} Although the letter of intent is a preliminary, skeletal, and nonbinding document, considerable care should be taken by both purchaser and seller (and their respective attorneys) in drafting this document, as the letter provides the basic framework for completing any further negotiations, clarifying any basic points of dispute arising prior to closing, drafting the basic acquisition documents to reflect the 'deal,' and consummating the acquisition in an amicable, expedient, and cost-efficient manner. Failure to pay close business and legal attention to the letter of intent invariably leads to substantial additional complexities in closing the transaction and may lead to the 'cratering' of the deal (with the attendant litigation that may follow). For further consideration of the letter of intent see Bryan, \textit{Letters of Intent, Public Announcements and Insider Trading}, in \textit{BUSINESS ACQUISITIONS}, \textit{supra} note 7, ch. 4.

\textsuperscript{227} The formal corporate action required of the board of directors and shareholders has already been discussed in section III(B), \textit{supra}. With respect to the due authorization of the transaction, it is essential that the resolutions be drafted to provide the negotiating parties sufficient authority to consummate the deal on its final terms. Failure to do so would impair the delivery of the required legal opinions at closing and would require a further vote of directors and/or shareholders. In addition to these concerns, appropriate resolutions (generally only from the directors, unless required by a charter document or other basic agreement) respecting any other agreements or arrangements that may be related to and required in connection with the acquisition must be considered. For further consideration of the care
(iii) Some form of basic acquisition agreement which will contain the specific terms of the transaction, including the price,\textsuperscript{228} manner of payment,\textsuperscript{229} material representations, warranties of the parties, material covenants of the parties to be undertaken prior to closing (which may be either affirmative or negative covenants),\textsuperscript{230} conditions to closing, and various other material terms.\textsuperscript{231}

(iv) Legal opinions—one of the key documents to the closing of any business transaction. The quality of the legal opinion will often determine the legal integrity of the transaction. In spite of how good the transaction may appear initially from a business sense, if the parties cannot be assured that the transaction will be legally valid, binding, and enforceable according to the terms of the various agreements involved, then the deal, from both a legal and business perspective, will be a bad deal.\textsuperscript{232} Although to the lay person the delivery of opinions may appear to involve only several paragraphs or pages of standard legal jargon, the delivery of a good legal opinion will require substantial legal and factual investigation and often may require the making of some very difficult judgments;\textsuperscript{233} and

(v) A finders agreement, if any finder or broker is involved.

In addition, if the acquisition is a merger, various formal documents, the Articles of Merger, will have to be filed with the Secretary of State.\textsuperscript{234}

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\textsuperscript{228} Obviously, price is of primary concern to seller and purchaser. Much time, expense, and effort is saved in the negotiating process if each side has a good idea of what he thinks is a fair price based on objective criteria. The difficulty with closely-held corporations is often the absence of any of the key traditional objective criteria for valuing a business (for example, industry comparison, market for stock, and extensive and reliable internal financial data). For further discussion see Rappaport, Do You Know the Value of Your Company?, 14 MERGERS & ACQUISITIONS No. 1 (Spr. 1979).

\textsuperscript{229} For consideration of such types of payments as a deferred-payment sale, installment sale, and contingent payout ('earnouts') see BUSINESS ACQUISITIONS, supra note 7, chs. 1, 9 & 10.

\textsuperscript{230} For consideration of the various types of representative warranties and covenants that may arise in an acquisition agreement and of their legal significance, see Weinreich, Contract of Sale, in BUSINESS ACQUISITIONS, supra note 7, ch. 5.

\textsuperscript{231} For further discussion of documentation see BUSINESS ACQUISITIONS, supra note 7, chs. 3, 4, 5 & 7.

\textsuperscript{232} For a copy of a sample opinion and the legal backup needed for its delivery, see app. 3, infra p. 625.


\textsuperscript{234} If part of the purchaser’s deal is the retention of key management of the acquired company, then the negotiation and preparation of mutually satisfactory employment agree-
If the consideration includes securities, or if the subject matter of the acquisition is securities of the acquired corporation, then sundry documents under the federal securities laws may be required. If the acquisition is a major acquisition, certain additional filings will be required. If a sale of assets is included, specific documents of conveyance, deed, bill of sale, certificate of authority, or otherwise, may also be required. In many acquisitions, various consents from governmental and private authorities may be required. Stock assignments may also be entailed.

VII. Concluding Observations

The attorney who is representing a closely-held corporation in an acquisition will inevitably find the process quite challenging. He or she will be required to identify, solve, and assimilate a series of complex and diverse legal and business issues; to participate actively in an overall planning process for structuring the transaction; to draft complicated documentation; to deliver sensitive legal opinions, and to facilitate the satisfactory closing of the transactions in all ways. Meeting these challenges will involve a great deal of time and will place arduous physical and legal demands and pressures upon the attorney. The greatest and
most pervasive demand, however, perhaps will be the ethical requirement to represent one's client competently.\textsuperscript{237}

\textsuperscript{237} See generally The Model Code of Professional Responsibility (1980), particularly Canon 6: "A Lawyer Should Represent A Client Competently." Under this Canon, a lawyer should not undertake representation in a complex acquisition situation unless he or she is competent to handle the diverse legal aspects of the transaction or, if the lawyer is not so competent, he or she is required to associate with a lawyer(s) competent to handle it (see DR 6-101). Another area of ethical concern in a closely-held corporate acquisition is the problem of multiple representation (in other words, representing multiple selling owners and the corporation, or representing both corporations). In all events, the attorney must determine who the client is, and if multiple clients are represented, that he or she has weighed fully the possibility that his or her judgment may be impaired or loyalty divided among clients, that he or she has made full disclosure to the clients and that he or she has received the informed consent of both clients. See Canon 5: "A Lawyer Should Exercise Independent Professional Judgment on Behalf of a Client" (and EC 5-14, 5-15, 5-16, 5-18, 5-19).
The following charts attempt to depict graphically the legal results of the various forms of corporate combination (assuming the consideration used is the stock of the acquiring corporation):

A = acquiring corporation
B = acquired corporation
S = subsidiary corporation
N = new corporation for a consolidation
X = shareholder(s) of acquiring corporation
Y = shareholder(s) of acquired corporation
Z = resisting shareholder(s) of acquired corporation
a&l = assets and liabilities
Statutory Merger

Before (Assumes consideration is all stock)*

- A Corp.
- B Corp.

- A&l of B Corp. (by operation of law)
- Stock from A
- Stock of B Corp. automatically cancelled

After

- A Corp.
  - (A's a&l)
  - (B's a&l)

- B Corp. goes out of existence by operation of law

*If cash were consideration (in whole or in part), to extent a shareholder of B Corp. would receive cash for his stock, he would be "cashed-out".
Consolidation

Before (in this case there is technically no acquiring and acquired corporation. Assumes consideration is all stock).

After:
Diagram 3

Triangular Merger (forward)

Before (assumes consideration is all stock).

After*

*In a reverse merger, S would go out of existence, B would become the subsidiary of A Corp., and Y & Z would become shareholders of A Corp., along with X.
Sale of Substantially All Assets

Before (assumes consideration is all stock):

A Corp.  
\[\xrightarrow{\text{Transfer of substantially all assets by contract}}\]  
A Stock  
\[\xrightarrow{\text{A Stock}}\]  
B Corp.

After (assumes B Corp. is subsequently liquidated, with B shareholders receiving A stock and B going out of existence. Sometimes B will remain in existence as a "shell corporation" holding a corporate name or as a corporation holding assets not sold):

A Corp.  
\(\text{(A's a&l)}\)
\(\text{(B's a&l)}\)

/ \  
X Y Z
Stock or for Stock Exchange

Before (assumes all stock is consideration and Z does not tender his shares of B):

After:*

*In a cash tender offer Y would be cashed out, and Z would remain as a minority shareholder of B (with A being B's parent).
ACQUISITION PROCESS

APPENDIX 2

ACQUISITION CHECKLIST (MERGER)

A. General Information Concerning Company to be Acquired.

Company Structure
1. Articles of Incorporation and amendments.
2. By-laws.
3. Minute books.
4. Stock transfer books and books of original issuance.
5. Jurisdictions where authorized to transact business.
6. Jurisdictions in which property owned or leased and offices maintained.
7. List of all subsidiaries.

Subsidiaries.
1. Above documents and information for each subsidiary to be acquired as a result of merger.

Stock Issuance and Related Matters.
1. List of names, addresses, and number of shares owned by each shareholder.
2. Outstanding options, warrants, or any other obligations to issue or repurchase capital or debt securities.

B. Financial Information Concerning Company to be Acquired.
1. Name of accountants, including name of partner in charge of the account.
2. Audited financial statements for past five years, if available.
3. Unaudited financial statements for all periods in which audited statements are not available.
4. Forecasted profit and loss statements and balance sheets for the current fiscal year and for the following fiscal year, if available, footnoted to explain abnormal, nonrecurring, or unusual items and the assumptions upon which the forecasts are based.
5. Breakdown of revenues according to major product categories, with comparable data for the previous year.
6. Accounts receivable aging schedule with comparable data for the previous year.
7. Description of bad debt experience, basis upon which reserves are established and adequacy thereof.
8. Current tax status, indicating the respective years through which the company has been cleared for federal, state, and foreign (if applicable) income tax purposes; any deficiencies proposed or assessed by any federal, state, or foreign income tax authorities.

9. Description of banking and credit relationships, including the names of each bank or other financial institution, the nature, limit, and current status of any outstanding indebtedness, loan or credit commitments and other financing arrangements that will survive merger.

10. Basis upon which any assets on the balance sheet have been revalued or recorded at amounts above or below cost.

11. Dividend history, if any.

12. Types and extent of dividend or similar restrictions; amount available for dividends under the most restrictive limitations that will survive merger.

C. **Contingent Liabilities and Obligations of Company to be Acquired.**

1. Schedule of all contingent liabilities and obligations not appearing on the balance sheet with respect to:
   (a) Leases;
   (b) Guaranties;
   (c) Deferred payment obligations under acquisition or other purchase agreements;
   (d) Product or service warranties;
   (e) Material oral commitments or understandings;
   (f) Stock repurchase obligations;
   (g) Unfunded pension or retirement obligations;
   (h) Circumstances under which the company may be required to repurchase or repossess assets or properties previously sold;
   (i) Commitments to finders or brokers;
   (j) Review of correspondence and other pertinent files relating to possible antitrust violations;
   (k) Product liability claims (if applicable);
   (l) Any form of off-balance sheet financing.

D. **Business of Company to be Acquired.**

1. Summary of the number, types, and functions of employees, and all documents describing the physical facilities utilized by the company.

2. Summary of major customers, including the names and addresses, products and the latest actual and estimated current year's sales to each of the 20 largest customers.
3. List of major suppliers, including name and address of each, types of products supplied and approximate dollar amount of purchases made from each in the last fiscal year and projected for the current year.

E. **Competition — List of Major Competitors.**

F. **Property and Facilities of Company to be Acquired.**
   1. Location, size, and use of major physical properties, including condition, extent of utilization, date constructed, extent of insurance coverage, and whether owned or leased.
   2. For leased facilities, date of lease, form of lease, major provisions thereof, annual rentals, rights of renewal, extension or purchase, total lease rentals and purchase options, if any, together with copies thereof.
   3. Location of principal executive offices.
   4. Location of sales offices and warehouses or similar facilities.
   5. Description of personal property such as automobiles, boats, airplanes, homes, recreational and other facilities, and memberships owned or maintained by the company.
   6. Summary list by category, age, and percentage depreciated of machinery, equipment, and other business equipment.
   7. Computer facilities owned or leased.
   8. Type, amount, and extent of encumbrances on company’s physical properties.

G. **Management of the Company to be Acquired.**
   1. Organization chart.
   2. List of directors, officers, and key employees, including:
      (a) Name;
      (b) Age;
      (c) Title;
      (d) Total compensation;
      (e) Explanation of non-salary compensation;
      (f) Transactions with the company either directly or through affiliates.

**Renumeration**

3. Aggregate direct renumeration paid to each director, officer, and key employee during last fiscal year and the current rate of compensation to each.
4. Amounts paid to all directors and officers as a group during the last fiscal year and projected amounts thereof for the current and succeeding fiscal years.
5. Description of all bonus, profit-sharing, pension, stock option, stock bonus, and other direct or deferred compensation plans, contracts, or arrangements, including the formula or method used and the total amount thereof for the past fiscal year and projected for the current year, and copies of all such plans, contracts, or arrangements.

6. Options granted and warrants issued to purchase stock within the past five years, including date of grant, name of optionee or warrant holder, exercise price, options, and warrants exercised.

Employees
7. Schedule of types (e.g., production, clerical, sales, etc.), locations, and number of employees.
8. List of current collective bargaining agreements, if any.
9. Extent of company's contractual or statutory liabilities upon severance, pay-off and for social benefits.
10. List of all employment or similar agreements, whether written or oral.

H. Capitalization of the Company to be Acquired.
1. Current summary of the number of authorized, issued, and outstanding shares of each class of stock.
2. List of all indebtedness of the company and subsidiaries.
3. Copies of all documents relating to long-term indebtedness of the company and its subsidiaries.
4. Reservation of unissued or treasury shares for specific purposes.
5. List of the amount of any of the company's securities owned by its subsidiaries.

I. Litigation Involving Company to be Acquired.
1. List of all pending or threatened litigation, arbitration, and governmental proceedings to which the company, any subsidiary or any of their directors, officers, or employees are a party, indicating the name of the court, agency, or other body before whom pending, date instituted, amount involved, current status, copies of pleadings, briefs and decisions filed or rendered in connection therewith, and opinions of counsel for the company with respect thereto.
2. Information as to any federal or state antitrust investigation or proceeding.
3. Copies of any Department of Justice merger clearances or refusals thereof or Federal Trade Commission "no action" letters or refusals thereof.
5. Internal Revenue Service ("I.R.S.") or other state or foreign tax proceedings, deficiencies assessed, or audits commenced.
6. If applicable, Securities and Exchange Commission (SEC) proceedings relating to the issuance or trading in the company's securities.

J. Industrial Property Rights of the Company to be Acquired.
1. List of all significant patents and patent applications, domestic and foreign, including date applied for or issued, number, country of issue, brief description of coverage, and significance to the company.
2. List of all principal trademarks, trade names, and copyrights.
3. List of all proprietary products not protected by patent and steps taken by the company to ensure the secrecy thereof.
4. Copy of forms of secrecy or other employment agreements and of numbers, locations, and types of employees covered thereby.

K. Transactions with Affiliates by Company to be Acquired.
With respect to company directors, officers, employees, or their affiliates:
1. Schedule of existing loans from company and subsidiaries setting forth date and amount of each advance, date, and amount of each repayment, balance due at end of each quarter, current balance, reasons for loans, terms thereof, together with copies of instruments evidencing such loans, any security therefor, and a statement of any plan for the repayment thereof.
2. Schedule similar to (1) above with respect to loans to the company or any of its subsidiaries.
3. Are any loans of the type described in (1) or (2) above contemplated in the future; are there at present any commitments or obligations to make such loans?

L. Information Disseminated Concerning the Company.
1. Copies of all annual and interim reports distributed by the company to its shareholders during the last three years.
2. Copies of all press releases issued by the company in the last year.
3. Proxy statements (if applicable).
4. Annual and other reports to regulatory commissions (including but not limited to the SEC).
5. Speeches to security analysts (if applicable).
6. Copies of any engineering, management, or similar report or memorandum relating to broad aspects of the company's business operations or products prepared by or for the company within the past year.
7. Copies of any market letters concerning the company known to have been issued within the last three years.

M. Public Offerings of Company to be Acquired.
1. Description, date, names of principal underwriters, and results of each prior public offering of any securities by the company or any of its stockholders.
2. Actual use of proceeds of each such prior public offering.
3. Copies of underwriting agreements for each prior public offering and whether there is any right of first refusal on subsequent financings.

N. Significant Contracts of Company to be Acquired.
1. List of all material contracts or understandings, indicating the material terms thereof, parties thereto, whether any party thereto is in default thereunder or claimed to be in default thereunder.
2. List of all licenses, permits or similar agreements relating to operations of the company's business.
3. Leases of real property, equipment, and computers.
4. Stock option agreements.
5. Consultancy agreements.
6. Copies of I.R.S. or other tax rulings relating to any merger or other tax-free reorganization.
8. Indemnification contracts or arrangements insuring or indemnifying any director or officer against any liability incurred in such capacity.
9. License, know-how, and technical assistance agreements.
10. Realty deed and mortgages.
11. Extent and nature of insurance coverage, including type of coverage, amount, and premium costs.
12. Indentures.
13. Loan agreements.
Preliminary Checklist for Rendering Opinion on Stock Acquisition

Set forth below is a checklist of what is required to support the opinion letter to ABC Corporation.


[1] State law
Corporate Charter.
Certificate of Incorporation.
Initial minutes.
Appropriate certificate from Recorder of Deeds of proper county in Delaware.
All minutes and related actions pertaining to amendments of corporate charter.

[2] Certificate of Good Standing from Secretary of State
Appropriate certificates from Recorder of Deeds of proper county in Delaware.
Check payment of franchise and other state taxes. Certificate of Good Standing from any relevant state administrative agencies (including statement that all necessary reports have files).
Certificate from secretary of corporation that no proceedings of a liquidation, dissolution, merger, consolidation, or sale of assets are pending.
Independent check of minute books to corroborate certificate from secretary of corporation.


[4] State law
Certificate of Good Standing from Secretary of State of New York and similar certificate from any relevant administrative agencies.
Authorization documents originally issued to ABC Corporation.
Corporate minutes related to above authorization documents.

[5] Certificates of Good Standing from Secretary of State and Certificate of Good Standing from any relevant administrative agencies.
Certificate from appropriate state official as to payment of franchise and other taxes.
II. "The Agreement has been duly executed and delivered by Seller and constitutes a valid, legal, and binding obligation of Seller, enforceable in accordance with its terms. . . ."

Check power to make sale and the required mechanics of sale under New York, Delaware, and any other relevant states laws and under Seller's charter.

Check authorizing resolutions of Seller's board.

Check validity of Agreement under New York law.

Check the subject of conflicts under New York law to make sure that the law which is specified in the contract is the law that will actually be applied by the courts of New York.

III. "[1] Each of the certificates representing shares of capital stock of the Acquired Company, delivered to you on the date hereof, is in proper form for transfer to you, and [2] upon such transfer you will receive good and marketable title to such shares, free and clear of all liens, charges, encumbrances, security interests, equities, options, and claims whatsoever. . . ."

[1] Check whether there are transfer restrictions on the face of the certificate.

Check whether any documents referred to on the face of these certificates contain transfer restrictions.

Check the corporate charter and by-laws for any possible transfer restrictions.

[2] Check Seller's corporate records to make sure the stock has not been pledged, assigned, etc.

Make general inquiry among Seller's creditors to make sure the stock has not been pledged, etc.

Check in Delaware for possible filing of a security interest in the stock.

Obtain certificate from secretary of the Seller that the stock is free and clear of all liens, charges, encumbrances, security interest, equities, options, and claims whatsoever.

IV. "The shares of capital stock of the Acquired Company, delivered to you by Seller pursuant to the terms of the Agreement, are exempt from registration under the Securities Act of 1933, as amended."

Make sure that the sale of these shares does not constitute one or more public offerings. Generally consider security law implications with respect to entire transactions, past securities problems concerning previous issuance of shares, insider trading, possible integration problems, etc.

Finally, the lawyer must check everything that New York counsel said in its opinion with respect to New York law.