Outline of Legal Aspects of Mergers and Acquisitions in the United States

15th Edition, September 2003

Pillsbury
Winthrop
Shaw
Pittman LLP

Houston • London • Los Angeles • New York • Northern Virginia • Orange County
Sacramento • San Diego • San Diego North County • San Francisco • Silicon Valley
Sydney • Taipei • Tokyo • Washington, DC

Outline of Legal Aspects of Mergers and Acquisitions in the United States

Introduction

This outline summarizes important aspects of United States law as it relates to mergers and acquisitions. It identified many significant issues relating to structuring and acquisition, including tax, accounting, corporate, securities, antitrust, trade regulation, environmental, intellectual property, insolvency, labor and employee benefits law. Any acquisition can also be expected to have unique legal concerns relating to the particular businesses in which the subject companies are engaged. In commencing work on any proposed acquisition, it is vital to involve counsel at an early stage to assist in identifying potential legal issues at a time when they are best resolved as well in structuring and negotiating the transaction.

As acquisitions become increasingly transactional because of the relaxation of trade barriers, the growth in the number of companies seeking a worldwide market and the geographic diversity of acquisition targets, the need to address cross-border issues in even seemingly uncomplicated acquisitions continues to expand. This Outline, now in its fifteenth edition, has grown accordingly so that its contents include the United States aspects of joint ventures, purchasing the business and/or assets of financially troubled companies and the regulation of foreign investment of ownership, and its distribution includes citizens of countries around the world. We welcome inquiries from the numerous individuals and organizations that make use of this Outline as to substantive matters and as to comments on how future editions can be made more useful to you. Please address any comments or suggestions regarding the Outline to Stephen R. Rusmisel at (212) 858.1442 or Jerry P. Peppers at (212) 858.1205.

The firm wishes to express its appreciation to Lynne R. Newofsky, Attorney-at-Law, in New York for preparing the Immigration section and Kenneth Wilchfort of Ernst & Young in New York for preparing the accounting section.

While this Outline describes many issues common to acquisitions, it is not intended to be a treatise or to constitute legal advice on any of these subjects. The Outline summarizes matters as of September 2003 and will therefore not reflect changes and developments which occur thereafter.

Table of Contents

Page

OUTLINE
OF
LEGAL CONSIDERATIONS
RELATING TO
MERGERS AND ACQUISITIONS
IN THE
UNITED STATES

I. <u>OVERVIEW OF LEGAL, STRUCTURAL, FINANCING AND OTHER CONSIDERATIONS.</u>

A. <u>Legal and Structural Considerations</u>. A number of factors must be considered before deciding upon even the most fundamental aspects of a transaction. For example, the tax advantages to an acquiror of a particular structure may be outweighed by the possibility that the acquiror may assume significant contingent liabilities arising by reason of the structure, such as product liability or pension or environmental liabilities.

B. <u>Financing Considerations</u>. In addition, the financing of a merger or acquisition can take a variety of forms, each with a number of differing legal consequences. The completion of financing arrangements and agreements regarding purchase price depends in part on the results of both business and legal due diligence. Because such due diligence review may not commence or be complete until after initial financing decisions and purchase price agreements have been made, early consideration of alternative financing options and related legal consequences can provide the flexibility that is often necessary later for final negotiations of the purchase price and for satisfying the business and legal concerns of sellers, purchasers, lenders and investors.

C. <u>Other Considerations</u>. From a legal standpoint, the most cost-effective and otherwise successful mergers and acquisitions result when parties involved in such transactions have some familiarity, before planning and negotiating a transaction, with the many legal considerations relating to mergers and acquisitions. Inefficiency and significant costs can be avoided by reviewing and discussing these considerations with counsel at an early stage. Our experience has shown that such timely review and discussion helps to (i) clarify and prioritize the objectives of a transaction; (ii) consummate a transaction in a timely manner; (iii) facilitate an efficient post-closing transition; and (iv) avoid disappointing and costly surprises about the value of acquired assets or stock or unknown liabilities (either those assumed by an acquiror or retained by a seller).

II. <u>BASIC FORMS FOR STRUCTURING ACQUISITIONS</u>. There are four basic forms for structuring acquisitions: (A) Merger or Consolidation; (B) Asset Purchase; (C) Stock Purchase; and (D) Joint Venture. These forms are summarized below, along with some observations regarding their relative advantages and disadvantages. Also included is a brief summary of privatization as a form of cross-border acquisition. In addition to corporate considerations, tax and accounting consequences may also be critical in determining the structure of a transaction. (See III and IV below.)

A. <u>Statutory Merger or Consolidation</u>. The terms "merger" and "consolidation" refer to the combination of two or more corporations, limited liability companies, limited partnerships or partnerships upon the affirmative vote of the requisite stockholders, members, limited partners or partners, as applicable, of the constituent entities, and the filing of a certificate in the jurisdiction(s) of incorporation, formation or organization, as the case may be. Some states also permit the merger or consolidation of one or more corporations with one or more limited liability companies, limited partnerships or partnerships. In a merger, the constituent entities are merged into one of the constituent entities, which is deemed to be the surviving entity of the merger. In a consolidation, the entities are consolidated to form a new entity. The stock, membership interests, limited partnership interests or partnership interests, as the case may be, of the non-surviving entity's(ies') stockholders, members, limited partners or partners, as applicable, is converted into stock, membership interests, limited partnership interests, partnership interests of the surviving or resulting entity, cash or some other form of consideration set forth in such certificate as a matter of law. Upon completion, the surviving or resulting entity carries on the combined business and the other(s) cease(s) to exist in separate form. (See

III.A.2 and III.B.1 for a summary of the tax considerations involved in mergers and consolidations.) Following are some structural variations of statutory mergers of corporations:

1. Direct Statutory Merger. Target is merged into acquiror and target's stockholders receive stock, cash, debt, property, or a combination thereof, of acquiror.

   (a) State corporation laws generally do not permit a direct merger of a United States ("U.S.") target into a foreign acquiror. Hence, most acquisitions using a foreign parent's stock are effected through a "triangular" merger with a U.S. subsidiary of the foreign parent as the acquiror.

   (b) Target is merged out of existence, which may be undesirable depending on the target's industry or the extent to which the target holds real property, nonassignable assets (including special franchises, licenses, permits, and local qualifications to do business) or contracts which require the consent of third parties to any assignment. This constraint also applies to consolidations and to "forward triangular mergers" described below.

2. Forward Triangular Merger. Target is merged into subsidiary (generally newly formed) of acquiror and target's stockholders receive stock, cash, debt, property, or a combination thereof, of acquiror (subsidiary's parent).

   (a) Results in the transfer of target's business (both assets and liabilities) to a wholly-owned subsidiary of acquiror.

   (b) Permits control over jurisdiction of incorporation, and maximum flexibility in terms of certificate of incorporation and by-laws.

   (c) Target is merged out of existence with the consequences described in 1(b) above.

3. Reverse Triangular Merger. Subsidiary of acquiror (generally newly formed) is merged into target, target's stockholders receive stock, cash, debt, property, or a combination thereof, of acquiror (subsidiary's parent) and shares of acquisition subsidiary are converted into shares of target.

   (a) Target becomes wholly-owned subsidiary of acquiror.

   (b) Target's corporate identity is preserved, mitigating the consequences described in 1(b) above (but not effective to prevent contractual or other consequences triggered by a "change of control").

4. Advantages. Advantages of all three forms of merger and of consolidation:

   (a) Total acquisition, and no minority stockholders remain after the merger;

   (b) Generally, no sales tax or bulk sales problems arise although there may be sales tax problems in some states with direct statutory mergers or forward triangular mergers; and

   (c) Relatively simple documentation.

5. Disadvantages. Disadvantages of all three forms of merger and of consolidation:

   (a) Acquiror must assume all liabilities of target (fixed and contingent, disclosed and undisclosed), but direct exposure of acquiror is limited in a triangular merger because such liabilities are of its subsidiaries;

   (b) Warranties will not normally survive the merger (although stockholder commitments may be obtained where target is closely held or where a discrete number of stockholders own a major block, or part of the consideration may be held back either in the form of escrow or a contingent payment for several years);

   (c) Stockholders of non-surviving corporations may have dissenters' appraisal rights permitting them to receive cash for their stock in an amount equal to an appraised market value set by a court; and

(d) Mergers or consolidations of different types of entities may be complicated by or prohibited under the laws of some states.

B. Asset Purchase. An acquiror may also purchase either substantially all, or only a part, of the assets of a corporate target in return for stock, cash, debt, property or a combination thereof. Advantages and disadvantages comparable to those described below generally also apply to a sale of assets by a limited liability company ("LLC"), limited partnership or partnership.

1. Advantages. In addition to the tax advantages noted in III below, there are the following advantages to a purchase and sale of assets:

(a) Can acquire all or only selected assets and all or only selected liabilities, whether contingent or otherwise (although, if substantially all assets are purchased, exclusion of liabilities may not be effective, especially where the seller no longer has economic substance);

(b) Can avoid dealing with minority stockholders in many circumstances;

(c) Unless purchasing substantially all of the assets, no stockholder vote of target is required; and

(d) Typically no appraisal rights for dissenting stockholders.

2. Disadvantages. In addition to the tax disadvantages noted in III below, there are the following disadvantages to a purchase and sale of assets:

(a) Corporate identity of target is not preserved for acquiror;

(b) More complex documentation requiring assignment and conveyance instruments (causing, in many instances, otherwise undisclosed problems to surface);

(c) May require numerous consents to assignment of contractual rights, potentially causing delay and giving rise to additional costs;

(d) May trigger acceleration of certain obligations and require prepayment of target's indebtedness;

(e) If significant amount of real estate is involved, transfer taxes, recording fees, etc. may be substantial;

(f) If intellectual property is registered in many jurisdictions, many assignments need to be filed;

(g) Possible sales tax and bulk sales problems; and

(h) If assets purchased and sold constitute "substantially all" of the assets of target, a stockholder vote of target is usually required.

C. Stock Purchase. An acquiror may gain control over a target by purchasing stock from the target's stockholders, rather than merging with the target or purchasing its assets. The acquiring corporation may negotiate with individual stockholders or, if the target is a public company, it may make a tender offer. (See IX below.) Advantages and disadvantages comparable to those described below generally also apply in the context of a purchase and sale of membership interests in a LLC, limited partnership interests or partnership interests.

1. Advantages. A stock purchase provides the following advantages:

(a) Target's corporate identity is preserved together with special franchises, licenses, permits and local qualifications to do business (other than those that may be affected by a change in control);

(b) Generally, no sales tax or bulk sales problems;

(c) Target's contract rights will not be impaired (unless specific contractual provisions require consent to changes in control);

(d) Relatively simple transaction when the target is closely held;

(e) Can be implemented through an exchange offer if management opposes the transaction;

(f) Where target is closely held, may implement hold back or escrow protection and can also provide for "earn out" component of purchase price;

(g) Even if acquiror is party to security documentation with an after-acquired property clause, target's assets may remain free from such a lien;

(h) It may be possible to avoid the need for the approval of the target's board of directors; and

(i) Simpler documentation because there is no need to transfer individual assets, rights and liabilities.

2. Disadvantages. In addition to the tax disadvantages noted in III below, this structure has the following disadvantages:

(a) May result in less than total acquisition with resulting minority stockholders, giving rise to possible future questions of fiduciary obligations to such stockholders; and

(b) Target is acquired subject to all its liabilities, including any undisclosed liabilities.

D. Joint Venture. Joint ventures are a common vehicle for combining business efforts, especially between entities from different countries. Joint ventures can provide a relatively low-cost means by which co-venturers can share benefits from particular assets or advantages, such as technology, expertise, name recognition, governmental contacts or financial clout. Joint ventures involve many issues, including antitrust concerns, which affect business combination activity generally. Joint ventures can be mere contractual arrangements or can be structured as jointly owned entities such as corporations, partnerships (either general or limited) or limited liability companies. Often the most complicated issues that arise out of entering into a joint venture are how to allocate and distribute the economic benefits of the joint venture and how to address the eventual end of the joint venture. Co-venturers will generally want their arrangement to be clear with respect to their respective rights as to allocation and distribution of the economic benefits of the joint venture, under what circumstances the joint venture may be terminated and the consequences of termination to each co-venturer.

1. Corporation. Co-venturers may set up a corporation in which they are the shareholders. Typically, the certificate of incorporation, by-laws and shareholders agreement will include provisions regarding management and control of the corporation, matters requiring super-majority approval, restricted transferability of interests, obligations to capitalize the corporation initially and on an ongoing basis, allocation and distribution of economic benefits of the joint venture, dispute resolution between the co-venturers and termination of the venture (such as buy-out provisions). The major advantage of a corporate structure is that the co-venturers' liabilities generally are limited to their equity in the corporation.

The major disadvantages of a corporate structure are that:

(a) The corporation will be a separate taxable entity, unless one of the co-venturers holds a significant enough share to allow consolidation, resulting in double taxation (mitigated for domestic co-venturers by the dividends received deduction) and the inability of either co-venturer to directly utilize losses;

(b) The corporate structure may be more restrictive with respect to allocation and redistribution of income and allocation and distribution of capital on dissolution; and

(c) Dissolution is a taxable event at both the corporate and co-venturer levels.

2. Partnership. Co-venturers may enter into a partnership agreement which governs their relationship with each other. Typically, the provisions in the partnership agreement cover those matters described above as included in corporate organizational documents, but with the addition of provisions covering issues such as management (usually by the general partner(s)), maintenance of capital accounts, allocations of gains and losses and administration of taxes. In order to limit a co-venturer's liability in the venture, general partnerships are usually structured with each co-venturer creating a corporate or

limited liability company subsidiary to be a general partner in the partnership. Sometimes a limited partnership structure is utilized, with the co-venturers investing as limited partners as well as the shareholders of the corporate general partner. Almost all states and the District of Columbia now recognize limited liability partnerships which generally limit a general partner's liability to that partner's own negligent acts or the negligence of employees under his (or its) direction.

The major advantages of a partnership structure are:

(a) The flexibility in structuring all aspects of the relationship between the partners, including contributions of capital and allocations of income, loss and distributions;

(b) The ability to pass income and losses directly through to the partners; and

(c) The ability to effect a dissolution with little or no tax cost.

The major disadvantages are:

(a) The partnership structure may not satisfy legal, political, marketing or convenience requirements;

(b) If not structured and administered carefully, management of the partnership may be awkward and limitation of liability jeopardized; and

(c) Partners may recognize gain from the partnership for income tax purposes without receiving any distribution from the partnership.

3. <u>Limited Liability Company</u>. Limited liability companies are recognized and permitted by statute in every state and the District of Columbia. The co-venturers, as members of a LLC, enter into an operating agreement which governs their relationship with each other. Typically, the provisions in the operating agreement cover those matters described above as included in a partnership agreement.

The major advantages of the LLC structure are:

(a) As in a partnership, the ability to pass through income and losses directly to the members;

(b) As in a partnership, the ability to dissolve the joint venture with little or no tax cost;

(c) As in a corporation, generally a co-venturers' liabilities are limited to its capital contribution obligations; and

(d) The ability to manage the company without jeopardizing the limited liability afforded its members.

The major disadvantages of the LLC structure are:

(a) The LLC structure may not satisfy legal, political, marketing or convenience requirements;

(b) Merger of a LLC with entities organized in or formed under the laws of jurisdictions other than the state in which the LLC is formed may be complicated by or prohibited under state law; and

(c) Members of a LLC may recognize gain from the LLC for income tax purposes without receiving any distribution from the LLC.

4. <u>Other Joint Ventures</u>. Sometimes co-venturers will combine their efforts through contractual arrangements, such as service agreements, consulting agreements, licenses, marketing alliances and other agreements by which respective contributions of assets and distribution of labor may be agreed. It is not unusual for a joint venture arrangement to be structured with a contractual component and also a combination of LLC, partnership and corporate entities interlocked to maximize the advantages and minimize disadvantages of such entities.

It is not unusual in complex joint venture arrangements to have combinations of partnership and corporate structures interlocked to maximize the advantages and minimize disadvantages of the various structures.

E. Privatization. The concept of "privatization" generally refers to any strategy or process that results in the transfer to a non-government entity of an asset or enterprise, in whole or in part, which is owned or controlled by a government. More precisely, privatization has been defined to mean "a strategy to shift the production of goods and services from the Government to the private sector in order to reduce Government expenditure and to take advantage of the efficiencies that normally result when services are provided through the competitive market place."

Like the concept itself, the various policies and programs that have been described as privatization have a considerable history. Policies designed to facilitate the substitution of the private sector for the public sector are not new. But the wide range of public sector activities that are now being considered for privatization and the unusual scope of the methods being suggested to achieve this objective distinguish privatization efforts today from those of the past.

Privatization, at least if defined broadly, is far more widely accepted than is generally acknowledged. The number of privatization transactions has increased in the last fifteen years. While in the past much international attention has been focused on the transfer of major national enterprises such as British Telecom and certain French banks from public to private ownership, scores of less-dramatic, smaller-scale cases of privatization exist at the state and local level in the United States, France, England, Germany, Spain and Japan, as well as in a number of developing countries in Latin America, Asia, and the former Eastern bloc countries of Europe.

1. Goals and Advantages. Among the goals and advantages of privatization are the following:

   (a) Privatization is seen as a means to reduce or eliminate the effects of politics on the operation of privatized businesses;

   (b) By eliminating bureaucratic interference, privatized companies can significantly improve operational efficiencies; and

   (c) Privatization can also encourage the development of domestic capital markets (by giving workers and citizens a direct stake in the value of the privatized company) and possibly lead to a reduction in public sector budget deficits (through cash receipts and future tax revenues), especially if the government involved can dispose of loss generating businesses.

2. Disadvantages. Counter-arguments against privatization include:

   (a) In numerous developing countries, publicly-owned production is the only business approach practicable. The economic return on investment is not seen as being sufficiently attractive to motivate potential private investors;

   (b) Employment opportunities are sometimes thought to be more stable under government ownership. With privatization might come significant layoffs of workers so as to reduce business costs; and

   (c) In some countries, government ownership of certain industrial or service sectors has been seen as a way of preventing potential domination of these industries by certain ethnic groups.

3. Methods of Privatization. The various types of privatization that are being used by both developed and developing countries, depending on their respective political and economic climates, are:

   (a) Contracting out by governments for provision of services (as is now sometimes done in the United States);

   (b) Building and operating public sector infrastructure by private sector parties (as in Argentina);

   (c) Management by the public sector but in a private sector mode (as in Spain and Italy);

(d) Public distribution of shares to the citizens through vouchers that can be exchanged for stock in a bidding process (as in Russia and the Czech and Slovak Republics);

(e) Sale of a public sector enterprise to outside investors (whether foreign or domestic);

(f) Management or employee buyouts;

(g) Sale of assets (rather than stock); and

(h) Global public offering of shares.

F. The Acquisition Agreement. The acquisition agreement is the basic document with respect to an acquisition. Since the buyer can never be fully familiar with the assets, business relationships, personnel, contingent liabilities and other facets of the business to be acquired, it will seek to negotiate an acquisition agreement in which the seller provides detailed information in these and other areas. Consequently, the largest part of the agreement will typically deal with seller's representations and warranties about the nature and condition of the business and assets being sold. Since the buyer often has the prerogative of preparing the first draft of the agreement, such representations and warranties are usually extensive and may be more or less tailored to the seller's business depending on the buyer's familiarity with it. The representations and warranties are then customized through negotiations between buyer and seller and continuing due diligence efforts by the parties and their representatives. The representations and warranties usually contemplate that the seller will prepare disclosure schedules that provide detailed information about the business, and seller typically indemnifies buyer against any damages resulting from the failure of the representations and warranties to be true. A buyer may seek further comfort by proposing to retain or hold back some portion of the purchase price against any indemnification that may become due to it for breaches of the seller's representations and warranties.

From a seller's standpoint, an acquisition agreement would ideally be very simple, selling the assets or corporate shares with few or no representations as to the condition or quality of what is being sold in return for immediately available funds representing the entire purchase price.

The acquisition agreement generally contains:

1. a description of the assets or shares to be sold;

2. a description of the purchase price to be paid, including any provisions for any post-acquisition adjustment to the purchase price (typically based on changes in working capital or net assets of the target from a reference date to the closing date) and earn-out provisions;

3. provisions for the mechanism of the closing, such as when and where the closing will be held, how the purchase price shall be paid and what deliveries shall be made at closing;

4. provisions for termination of the agreement and any break-up fees;

5. representations and warranties of both the buyer and the seller (the seller's representations would normally be quite detailed with respect to the operation of its business while the buyer's representations are generally limited to matters bearing on its ability to perform the transaction, except that buyer's representations may be more extensive if equity of the buyer is a significant component of the purchase price);

6. provisions regarding the conduct of the target business and any further actions that may be required between the agreement and closing dates;

7. covenants effective during the post-acquisition period relating to such matters as buyer and seller may agree, which often include restrictions on competition by the seller, rights and duties with respect to taxes related to the sold business and the maintenance of benefits for transferred employees;

8. conditions precedent to the obligation of each party to close, including the continued accuracy of representations and warranties as of the closing date and the receipt of necessary approvals of third parties;

9. provisions regarding the length of time that the representations, warranties and covenants will survive;

10. indemnification provisions often specifying thresholds and/or ceilings of liability with respect to indemnification obligations, procedures for resolving disputes (particularly breaches of the seller's representations and warranties) and any holdback or escrow of a portion of the purchase price against such indemnification obligations; and

11. provisions covering the termination of the agreement (prior to closing);

12. provisions covering miscellaneous matters such as transaction expenses and conventional "boilerplate" provisions dealing with choice of law, jurisdiction, notices, severability, assignment, counterparts and other matters.

G. The Merger Agreement. An agreement and plan of merger is the principal document typically used in a merger. A merger, which requires the approval of the holders of at least a majority of the outstanding voting stock, is often used to effect the equivalent of a stock purchase without the need for the approval of all shareholders, some of whom may be unable or unwilling to give such approval. The contents and structure of an agreement and plan of merger in a private transaction generally parallel those of the acquisition agreement used in an asset or stock purchase, except that an agreement and plan of merger contains those provisions necessary to carry out a merger, including provisions for making necessary state filings and for converting the capital stock of the merging corporations. For the same reasons that a merger may be chosen for the structure of a transaction (e.g. a large number of unrelated stockholders from which consent may be difficult to obtain; as is always the case with a company that has publicly traded stock and as may also be the case with relatively widely-held private companies), often the consideration in a merger is widely distributed. In transactions where a public company is acquired (and occasionally where a widely-held private company is acquired) the representations and warranties do not survive the closing and indemnification provisions are omitted. In such circumstances, the primary significance of representations and warranties is with respect to the conditions to closing. Even in the case of widely-held companies, it is possible to structure indemnification, typically by escrowing or holding back a portion of the purchase price.

III. TAX CONSIDERATIONS.

A. Tax Free Reorganizations.

Certain transactions can be structured so that target stockholders and security holders will recognize no gain or loss except to the extent that the gain or loss realized is attributable to the receipt of "boot" (i.e., generally, any consideration other than stock, securities or warrants of the acquiror or, in limited circumstances, its parent).

1. Permissible Consideration.

(a) Stock. Subject to an exception for "nonqualified preferred stock" (discussed below), target shareholders that participate in a tax-free reorganization generally will not be taxed to the extent they receive acquiror stock (or, in certain circumstances, stock of the acquiror's parent).

(b) Securities. Target security holders that participate in a tax-free reorganization will not be taxed to the extent they receive securities of the acquiror (or, in certain circumstances, securities of the acquiror's parent) with a principal amount that does not exceed the principal amount of the target securities exchanged.

(c) Warrants. Target shareholders and security holders that participate in a tax-free reorganization will also not be taxed to the extent they receive warrants of the acquiror (or, in certain circumstances, warrants of the acquiror's parent). However, note the warning in III.A.3(a) below.

(d) Nonqualified Preferred Stock. "Nonqualified preferred stock" received by a target shareholder in an otherwise tax free reorganization will be treated as taxable "boot." Nonqualified preferred stock is stock that is limited and preferred as to dividends and does not participate in corporate growth to any significant extent. Note that a conversion privilege by itself will not necessarily cause preferred stock to participate. In addition, subject to certain special exceptions, the stock must (i) be putable or mandatorily redeemable, or (ii) be subject to an issuer call that, as of the issue date, is more likely than not to be exercised, or (iii) bear a dividend rate that varies in whole or in part with reference to interest rates, commodity prices or other similar indices. In the case of clauses (i) and (ii), the right or obligation must be exercisable prior to the twentieth anniversary of the issue date and must not be subject to a contingency that makes exercise remote.

2. Transaction Structures.

(a) Statutory Merger or Consolidation ("A" Reorganization). (See II above for a summary of the corporate considerations and the advantages and disadvantages of the forms of mergers set forth below.)

(i) Direct Statutory Merger. In a direct statutory merger, the target is merged into the acquiror under applicable state law and the acquiror survives. The target's shareholders generally receive shares of stock of the acquiror. (This type of transaction can also be done as a "consolidation" of two corporations into a third.) A direct merger affords an acquiror a good deal of flexibility in choosing the type of consideration offered to the target shareholders and in disposing of unwanted target assets.

A. Under a "safe harbor" contained in the Internal Revenue Service ("IRS") ruling guidelines, a merger will still be tax-free where up to 50% of the stock of the target is acquired for cash in anticipation of or pursuant to the merger, provided the remaining target shareholders receive either voting or nonvoting common or preferred stock (other than nonqualified preferred stock) of the acquiror in the merger. (See III.A.3(a) below.)

B. Unlike the "C" reorganization and triangular-merger reorganizations discussed below, there is no requirement that "substantially all" of target's assets be acquired or retained by the acquiror.

C. In a variation, the target is permitted to merge into a LLC that is wholly owned by the acquiror and therefore treated as a "disregarded entity" under the so-called "check-the-box" entity classification rules.

(ii) Forward Triangular Merger. In a forward triangular merger, the target is merged into a subsidiary (usually newly formed) of the acquiror and the subsidiary survives. The target's shareholders receive shares of stock of the acquiror (the subsidiary's parent).

A. As with a direct statutory merger (see III.A.2(a)(i) above), there is flexibility as to the forms of consideration that may be used.

B. The subsidiary must acquire and retain "substantially all" of the target's assets (generally, 90% of net assets and 70% of gross assets under the IRS guidelines). This requirement limits pre- and post-merger dispositions of unwanted target assets.

C. Stock of the subsidiary may not be used as consideration.

(iii) Reverse Triangular Merger. In a reverse triangular merger, a subsidiary of the acquiror (usually newly formed) is merged into the target and the target survives. The target's shareholders receive shares of stock of the acquiror (the subsidiary's parent) and shares of the subsidiary's stock are converted into shares of stock of the target.

A. In a reverse triangular merger, there is less flexibility as to permissible forms of consideration than with either the direct merger or the forward triangular merger. The target's shareholders must exchange an amount of target stock that constitutes "control" of the target (defined as 80% of voting power and 80% of each class of non-voting stock) for voting stock (common or preferred) of the acquiror. Thus, the acquiror cannot acquire more than 20% of any class of target stock for "boot" as part of the merger or in any transaction outside the merger. In the absence of contrary guidance from the IRS, voting nonqualified preferred stock should count in determining control. On the other hand, warrants do not count in determining control even though they can be received tax-free in the merger.

B. As in a forward triangular merger, the target must acquire and hold "substantially all" of its (and the subsidiary's) assets immediately after the merger.

C. In certain circumstances, a reverse subsidiary merger followed by an upstream merger of the target into the acquiror can also qualify as a tax-free reorganization.

(b) <u>Stock-for-Stock Acquisition ("B" Reorganization)</u>. In a "B" reorganization, the target's stock is acquired solely for voting stock (common or preferred) of the acquiror or the acquiror's parent. This type of transaction is relatively uncommon and a reverse triangular merger is generally the preferred structure. (See II above for a summary of the corporate considerations and the advantages and disadvantages of stock purchases.)

(i) The acquiror (or its parent) must issue *solely* voting stock in exchange for the target stock. Absolutely no "boot" is permitted (<u>i.e.</u>, the acquiror cannot, as part of the same plan, acquire any target stock for consideration other than acquiror voting stock, ruling out acquiror warrants). In the absence of contrary guidance from the IRS, target shareholders' receipt of voting nonqualified preferred stock should not poison a "B" reorganization.

(ii) The acquiror must own target stock constituting "control" of the target after the transaction. (See III.A.2(a)(iii)(A) above for the definition of "control.")

(c) <u>Stock-for-Assets Acquisition ("C" Reorganization)</u>. In a "C" reorganization, assets of the target are acquired for voting stock of the acquiror or the acquiror's parent. This transaction is relatively uncommon and the direct statutory merger or the forward triangular merger is generally the preferred structure. (See II above for a summary of the corporate considerations and the advantages and disadvantages of asset purchases.)

(i) As in a forward or reverse triangular merger, the acquiror must acquire "substantially all" of the target's assets.

(ii) With one exception, consideration is limited to voting stock (common or preferred) of the acquiror or the acquiror's parent. (In the absence of contrary guidance from the IRS, voting nonqualified preferred stock should be permitted.) The exception is that "boot" may constitute up to 20% of the consideration, but only if the target's liabilities (which would otherwise be ignored) are also counted as "boot." Because an operating business typically has significant fixed and contingent liabilities "boot" is not typically used.

(d) <u>Acquisition of Bankrupt Company ("G" Reorganization)</u>. In a "G" reorganization pursuant to a plan of reorganization approved by a bankruptcy court or by a court in receivership, foreclosure or other similar proceedings, substantially all the assets of the target are acquired for common or preferred stock (in addition to debt securities, typically) of the acquiror or its parent.

(i) Consideration need not be limited to voting stock.

(ii) Target shareholders need not maintain a proprietary interest in the acquiror. Creditors that receive stock in satisfaction of their claims are generally treated as shareholders for purposes of determining whether the "continuity of interest" requirement is satisfied. (See III.A.3(a) below.)

(iii) Sales of target assets, effected prior to the acquisition for the purpose of satisfying the claims of creditors, generally will not result in a failure to satisfy the "substantially all" requirement. (See III.A.2(a)(ii)(B) above.)

3. General Requirements.

(a) Continuity of Shareholder Interest. All tax-free reorganizations must preserve the target shareholders' "proprietary interest" in the acquiror. Although there is no hard and fast rule as to what amount of stock the target shareholders must receive to preserve continuity of interest, the IRS ruling guidelines will be satisfied if the target shareholders receive an amount of stock of the acquiror (or its parent, if permissible) equal in value to at least 50% of the formerly outstanding target stock. In the absence of contrary guidance from the IRS, nonqualified preferred stock should count toward preserving continuity of interest even though receipt of nonqualified preferred stock is taxable. Warrants, however, will not count in preserving continuity of interest. Finally, former target shareholders may sell their interests immediately before or after the acquisition without threatening continuity of interest as long as they sell to parties unrelated to the acquiror.

(b) Continuity of Business Enterprise. It is a further requirement of all tax-free reorganizations that the acquiror either continue a line of the target's historic business or use a significant portion of the target's historic assets in a business. This requirement is generally satisfied if the target's assets are redeployed within the acquiring corporation's "qualified group" (defined as a group of corporations in which 80% of the vote and value of at least one member of the group is owned by the acquiror, and each other member of which is similarly owned by another member).

(c) Step-Transaction Doctrine. If the overall acquisition plan involves not only a tax-free reorganization described above but also another transaction, under the "substance over form" or "step-transaction" doctrine, the related transactions may be viewed together in determining their effect. This may result in a recharacterization of the putative reorganization, which may change its tax consequences. For this reason, it is important to consider the potential effect of any related transaction.

4. Acquisition of Domestic Target by Foreign Acquiror. If a transaction involves the acquisition of a domestic target corporation by a foreign acquiror, the following additional conditions generally must be satisfied for the transaction to be tax-free to the domestic target shareholders:

(a) In the transaction, domestic target shareholders must receive, in the aggregate, 50% or less (by vote and value) of the foreign acquiror's stock outstanding immediately after the transfer.

(b) After the transaction, domestic insiders of the domestic target corporation (i.e., directors, officers or 5% shareholders) must own, in the aggregate, 50% or less (by vote and value) of the foreign acquiror's stock (whether or not the stock was acquired in the transaction).

(c) The foreign acquiring corporation (or certain qualified subsidiaries or partnerships) must have an "active trade or business" outside the United States for the preceding three years and there can be no intention on the part of the foreign acquiror or the transferring shareholders to dispose of or discontinue that trade or business.

(d) The fair market value of the foreign acquiror must be at least equal to the fair market value of the domestic target at the time of the transaction.

(e) If, after the transaction, a domestic target shareholder owns 5% or more (by vote or value) of the foreign acquiror's stock (whether or not the stock was acquired in the transaction), the shareholder must sign a "gain recognition agreement." The agreement generally requires that the shareholder recognize any gain inherent in the domestic target stock at the time of the transaction if the shareholder disposes of the foreign acquiror's stock within five years or certain other events occur.

(f) The domestic target must file a detailed information statement.

5. Acquisition Involving a CFC Target. If the target is a "controlled foreign corporation" (a "CFC"), then a domestic 10% target shareholder may be required to recognize deemed dividend income if, after the transaction, either the foreign acquiror is not a CFC or the domestic 10% target shareholder holds less than 10% of the foreign acquiror's voting stock. For this purpose, a foreign corporation is a CFC if 50% of its stock is held by domestic shareholders, each of which holds at least 10% of its voting stock.

6. Additional Considerations.

(a) A tax-free reorganization defers recognition of gain for the target and the target's shareholders, and the acquiror inherits the tax basis of each of the target's assets as well as the target's other tax attributes.

(b) A tax-free reorganization requires the issuance of stock of the acquiror or its parent.

(i) Registration under applicable securities laws is required unless an exemption is available.

(ii) A tender offer may require enhanced financial disclosure.

(iii) Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), as amended, and Rule 10B-5, promulgated thereunder, are applicable to the disclosure.

(iv) State "blue sky" qualification may be required.

(v) If the stock is not registered, it may be necessary for the acquiror to grant registration rights (either demand rights or "piggy-back" rights) to the target stockholders.

(vi) Under certain circumstances, large stockholders or other central persons to the target may be restricted from selling the consideration stock for some period.

B. Taxable Transactions.

1. Merger for Cash and/or Notes. Any of the forms of tax-free merger discussed above may be utilized in a taxable merger, in which case the target's shareholders will typically receive cash or notes or a combination of the two.

(a) The corporate advantages and disadvantages are generally the same as for a tax-free statutory merger or consolidation. (See II above.)

(b) If the target merges into the acquiror or a subsidiary of the acquiror (i.e., a "forward merger") in a taxable merger, the transaction is treated as a taxable sale by the target of its assets, followed by a liquidation of the target. Gain is taxable to both the target and the target shareholders, and the acquiror's tax basis in each target asset is "stepped up" to fair market value.

(c) If a subsidiary of the acquiror is merged into the target (i.e., a "reverse merger") in a taxable merger, the transaction is treated as a purchase by the acquiror of the target stock. Gain is taxable only to the target shareholders, and the acquiror receives a tax basis in the target stock equal to its cost (while the target retains its pre-acquisition tax basis in its assets).

2. Purchase of Stock for Cash and/or Notes.

(a) The corporate advantages and disadvantages are generally the same as for a tax-free stock-for-stock acquisition. (See II above.)

(b) The target stockholders are taxed on their gain, and the acquiror receives a tax basis in the target stock equal to its cost (while the target retains its pre-acquisition tax basis in its assets).

(c) If the target is a member of an affiliated group of corporations filing consolidated Federal income tax returns, an affiliated group filing separate returns, or an S corporation, the acquiror may, with the cooperation of the seller or sellers, elect to treat a purchase of at least 80% of the target stock as though the target had, in effect, sold its assets to a newly organized corporation and then liquidated. The consequences of such a "section 338(h)(10) election" are as follows:

(i) The acquiror will receive the benefit of a "stepped-up" depreciable and amortizable tax basis in the assets of the target.

(ii) Any gain realized by the target as a result of the deemed sale of its assets may be sheltered by its own net operating losses and tax credits, as well as any net operating losses and tax credits of its selling consolidated group.

(iii) Gain is taxable to the target, but generally not to the target shareholders.

(d) A stock acquisition by tender offer typically involves a taxable purchase of most of the target's stock by a subsidiary of the acquiror, followed by a "reverse merger" of the subsidiary into the target (see III.A.2.(a)(iii) above) to eliminate minority shareholders. The entire transaction is effectively treated as a taxable purchase of target stock by the acquiror.

3. Purchase of Assets for Cash and/or Notes.

(a) The corporate advantages and disadvantages are generally the same as for a tax-free stock-for-assets acquisition. (See II above.) In addition, in a taxable asset purchase, the acquiror may selectively acquire only certain assets and assume only certain liabilities.

(b) The target is taxed on the assets that it sells even if it follows the sale with a complete liquidation. Upon any such liquidation, the target shareholders are generally also taxed on the gain realized on their target stock (unless the target is an S corporation or has an 80% or greater domestic corporate shareholder).

(c) The acquiror receives a tax basis in each asset equal to the amount of the purchase price allocable to it.

4. Installment Sale. If the acquiror purchases stock or assets and the parties agree that payment will be made, in whole or in part, after the close of the taxable year in which the sale occurs, the seller may be able to account for and report any gain (but not loss) under the installment method (i.e., gain will be taxed only as actual payments are received).

(a) The acquiror can defer payment of all or a part of the purchase price with seller financing, often at a favorable interest rate. Special rules apply to notes or deferred payments that bear below-market interest rates or that include contingent payments of interest or principal.

(b) The target or selling shareholders can defer recognition of gain for tax purposes, but the tax benefit for the target or selling shareholder is substantially reduced to the extent proceeds, to any seller, exceed $5,000,000.

(c) Installment-method reporting is available for most deferred-payment sales, but is not available for the sale of publicly traded securities.

(d) A deferred payment that is supported by a third-party guarantee or stand-by letter of credit does not constitute a payment in the year of sale. However, a purchaser's note that is payable on demand or readily tradable (as well as the note of a third party) will be treated as a payment in the year of sale. Furthermore, the purchaser's notes may be subject to pledge restrictions.

C. Hybrids and Variations on Basic Forms.

1. Holding Company Formation. Certain target shareholders may "roll over" their target stock into stock of a holding company formed (and primarily owned) by the acquiror (or a subsidiary of the acquiror). This technique is typically used when minority shareholders of a publicly traded target wish to avoid a taxable sale or exchange, but the acquiror wishes to purchase a majority of the shares of target stock for cash and/or notes.

(a) The "rollover" target shareholders can receive stock of the holding company (preferred or common, voting or non-voting), other than nonqualified preferred stock, tax-free, while the other target shareholders can receive cash or notes in a taxable transaction.

(b) There is no minimum amount of holding company stock that must be issued to the "rollover" shareholders.

(c) Variations include interposing a holding company above both the target and the acquiror.

2. Contingent Stock or Stock Earn-Out Arrangements and Stock Escrow Arrangements. Such arrangements are generally permitted in tax-free reorganizations.

(a) IRS guidelines for contingent stock or stock earn-out arrangements require, among other things: (i) the issuance of all such stock within five years; (ii) a valid business reason for the arrangement; (iii) a stated maximum number of issuable shares, 50% of which must be issued in the initial distribution; (iv) non-assignability of the right to receive the stock; and (v) the use of only acquiror stock.

(b) IRS guidelines for a stock escrow arrangement require, among other things: (i) the release of all stock (which must be validly issued and outstanding) within five years; (ii) a valid business reason for the arrangement; (iii) current distribution of all dividends to the target shareholders; and (iv) voting rights exercisable by the target shareholders.

3. Net Operating Loss Carryforwards. The acquisition of a corporation with net operating losses ("NOLs"), investment credits or other tax attributes presents special problems.

(a) Use of a corporation's NOLs and certain other of its tax attributes is substantially limited if the stock ownership (by value) of the corporation changes by 50% over a three-year period. If a triggering ownership change occurs, the use of pre-change NOLs and other tax attributes against the corporation's post-change profits is subject to an annual limitation equal to the product of (i) an amount equal to the fair market value of the equity of the corporation before the ownership change and (ii) a prescribed interest rate.

(b) Very generally, carryovers will be lost if the principal purpose of the acquisition (or the principal motivation behind a particular structure) is to secure their benefit.

4. Joint Ventures and Pass-Through Entities. Pass-through entities are commonly used to structure asset acquisitions and joint ventures. The three entities discussed below generally incur no Federal income tax liability at the entity level; rather, they pass items of income and loss through to their equity participants. (See also II.D.)

(a) Partnership. A partnership can take the form of a general partnership (in which all partners share in the liabilities of the partnership) or a limited partnership (in which one or more general partners are joined by limited partners, who may not participate in the management of the partnership business and who have limited liability). A partnership is a pass-through entity for Federal income tax purposes and allows for extremely flexible allocations of taxable income and loss. (See also II.D.2.)

(b) Limited Liability Company. A LLC with two or more members can elect to be treated as a partnership or a corporation for Federal income tax purposes. Consequently, an LLC can obtain pass-through treatment for Federal income tax purposes in the same way as a partnership, but will confer the benefit of limited liability on all of its members. A single-member LLC can elect to be treated as a corporation or disregarded as an entity separate from its owner. An LLC need not satisfy the strict eligibility requirements pertaining to an S corporation and it offers the same allocation flexibility as a partnership. Although the law and practice of LLCs are still relatively new, they are increasingly seen as an alternative to partnerships (general and limited) and S corporations.

(c) S Corporation. An "S corporation" is a corporation that elects to be taxed generally in a manner similar to a partnership (i.e., on a pass-through basis). Under current law, the shareholders of an S corporation may not exceed 75 in number, and they must all be individuals who are United States citizens or residents (or certain trusts or estates). In addition, a wholly-owned S corporation subsidiary can elect to be disregarded as a separate entity from its parent. However, S corporations generally lack the allocation flexibility of partnerships and LLCs.

IV. ACCOUNTING FOR BUSINESS COMBINATIONS. During 2001 the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standards No. 141, *Business Combinations*, and No. 142, *Goodwill and Other Intangible Assets* (together, the "Statements"). The Statements prohibit the use of the pooling-of-interests method for business combinations and require that acquisitions initiated after June 30, 2001 be accounted for as purchases. A purchase is accounted for as the acquisition of assets and assumption of liabilities at fair value (i.e., the purchase cost) by an acquiror. Goodwill will be recorded if the purchase price exceeds the fair value of the net assets acquired. The results of the target are reflected from the purchase date; the prior results of the acquiror are not restated.

Negative goodwill is recognized immediately in income as an extraordinary gain. Negative goodwill (under present rules which are being revised) is the amount that results after all nonmonetary, noncurrent assets have been reduced to zero.

A. Goodwill. Under the Statements, goodwill should be initially recognized as an asset in the financial statements. Goodwill is measured as the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired (including identifiable intangibles) and liabilities assumed. Goodwill, including goodwill that exists at the effective date of the Statements, must be allocated to the acquiring company's "reporting units", as defined under the Statements. Goodwill should *not* be amortized but should be tested for impairment at the reporting unit level. A "reporting unit" will be an operating segment or smaller sub-set of a company.

B. Goodwill Impairment Testing. Goodwill must be tested for impairment within six months of adoption of the Statements (which are now effective for virtually all companies) by comparing the fair value of the reporting unit to its carrying value. If the carrying value exceeds the fair value, additional computations are required to determine the amount of the impairment. Subsequent to the initial impairment test, an annual determination of fair value of the reporting unit is required unless certain criteria are met. In addition, there are indicators that would require interim goodwill impairment testing.

C. Intangible Assets Other than Goodwill. A recognized intangible asset should be amortized over its useful life and reviewed for impairment. A recognized intangible asset with an indefinite useful life should *not* be amortized until its life is determined to be finite. The FASB agreed that the useful life of an intangible is *indefinite* when the life extends beyond the foreseeable horizon. The Statements also clarify that indefinite does not mean infinite and that the useful life of an "intangible" asset should not be considered indefinite because a precise finite life is not known.

The Securities and Exchange Commission ("SEC") is expected to closely scrutinize the allocation of purchase price between non-amortizable intangible assets, goodwill and amortizable intangible assets.

D. Acquisitions of Less Than All of a Business.

1. If the acquisition results in the acquiror obtaining control of the target (generally involving an acquisition of more than 50% of the voting stock), the acquisition will be included in the acquiror's consolidated financial statements. All assets and liabilities will be recorded at fair value to the extent of the change in control and the minority interest will be shown between liabilities and equity in the acquiror's balance sheet. For accounting purposes, the acquiror is generally the entity whose shareholders and management emerge in control, not necessarily the legal survivor.

2. If significant influence over a target has been obtained, but not control (generally involving between 20% and 50% of the voting stock), the equity method of accounting will be used. The investment will be shown as one line on the balance sheet and the acquiror will reflect in its income statement its share

of the results of the target, as adjusted, for amortization of the excess purchase price, including identifiable intangibles, on one line. Goodwill and indefinite lived intangibles will not be amortized. However, the entire investment will be subject to an impairment review.

3. If significant influence over an investment has not been obtained (generally less than 20% of the voting stock), an investment in a private company will be accounted for at the lower of cost or market, and generally only dividends received will be included in the income of the acquiror. If the investment is in a public company, the investment will be carried at market with changes in market value being included in income or comprehensive income based on the designation (trading vs. available for sale) given to the investment.

4. When a holding company with no substantive operations acquires only a portion of an operating company in a leveraged buyout ("LBO") transaction, complicated issues arise regarding what basis of accounting should be utilized by the holding company in valuing its interest in the operating company. This issue, discussed at length in the FASB's Emerging Issues Task Force Issue No. 88-16, is complex and requires consultation with accounting professionals because of the potentially significant impact on the financial statements of the companies.

5. When less than all of a business is acquired, the separate financial statements of the acquired entity may reflect the acquisition as a capital transaction ("recap") in lieu of a purchase business combination. The criteria impacting this determination are not easily identified in accounting literature and are subject to interpretation. Therefore, consultation with accounting professionals is required.

V. <u>FINANCING CONSIDERATIONS.</u>

A. <u>Sources of Capital for Payment of Purchase Price</u>.

1. Self-generated by acquiror (includes cash from operations, lines of credit, commercial paper).

2. Proceeds of acquisition financing:

(a) <u>Senior Debt</u>.

(i) May include term loans (usually secured by real estate and other property, plants and equipment) and revolving credit lines for working capital purposes (usually secured by inventory and receivables).

(ii) Acquired company's assets may be pledged as collateral (LBO).

(iii) Loans may be made by a single bank or group of banks, depending upon size of transaction.

(iv) Recently, insurance companies, mutual funds, hedge funds, finance companies and other non-bank financial institutions have been participating in this market.

(v) Senior debt can also be used to enable an employee stock ownership plan ("ESOP") to acquire target stock. (See XIX for a discussion of ESOPs.)

(b) <u>Mezzanine Securities</u>.

(i) Debt securities junior to senior debt sold to finance acquisitions are widely known as "mezzanine" debt and include so-called "high-yield" or "junk" bonds.

(ii) Mezzanine debt may be sold in private transactions or through registered transactions depending upon the size and nature of the mezzanine portion.

(iii) Purchasers include banks, insurance companies, pension and mezzanine investment funds, other institutional investors and wealthy individual investors.

(iv) Generally subordinated to the senior debt and usually unsecured. It is not unusual for two or more layers of mezzanine indebtedness, each subordinate to the next more senior layer, to be issued in order to achieve optimum capitalization; sometimes, the senior debt will require the mezzanine debt to be held at the holding company level in order to structurally subordinate such debt to the senior debt of the operating company and to keep the balance sheet of the target operating company more attractive for fraudulent conveyance purposes.

(v) Some mezzanine securities have been structured to defer cash interest payments, such as "zero-coupon" bonds, and others may pay interest currently, but in additional securities rather than cash ("pay-in-kind" securities).

(vi) Often have equity "kicker" in form of convertible feature or separate warrants.

(c) Equity Securities.

(i) Include both preferred and common stock. (See VI below for a description of American Depositary Receipts ("ADRs").)

(ii) Have traditionally been sold to financial institutions interested in an equity level participation in leveraged acquisitions and also to LBO funds and other institutional investors, pension funds (subject to complex rules under the Employee Retirement Income Security Act of 1974, as amended ("ERISA")) and management groups.

(iii) Generally raised in private transactions not involving registration under the securities laws.

(iv) Pay-in-kind feature has also been used extensively, in lieu of cash dividends, in preferred stock issued to institutions in leveraged acquisitions.

(d) Bridge Financing.

(i) Investment banks and other sources may provide short term so-called "bridge" financing to bridge the gap between such immediately available sources of financing and longer term financing or asset sales.

(ii) Generally intended to be repaid promptly after the completion of the acquisition through sales of assets or securities or other refinancing.

(e) Rights Offerings.

(i) Background. Rights offerings are commonly utilized by many non-United States companies, often because of legally mandated preemptive rights. In the United States, rights offerings are being considered with greater frequency as a means of raising capital. In a rights offering, an issuer makes an offer to existing shareholders, usually on a pro rata basis and for a specified exercise period, to sell securities for a cash price which is typically less than the pre-offering market price of such securities. Rights offerings are generally underwritten or are structured as placements with "clawback" rights on the part of shareholders. Historically many issuers have excluded or cashed out United States shareholders from rights offerings because of United States regulatory constraints.

A. Underwritten Rights Offerings. Under this form of offering, underwriters commit to purchase the securities on a standby basis, i.e., to the extent that existing shareholders do not take up their rights. Issuers may distribute "provisional allotment letters," which evidence the issuance of the securities in "nil-paid" form. The rights to purchase the securities may themselves be transferable, in which case a trading market for the rights themselves arises during the subscription period, with shareholders who do not wish to purchase the underlying securities selling the rights into the market. Upon receipt by the issuer of the subscription price and an executed provisional allotment letter, the subject securities become fully paid and non-assessable.

B. Clawback Offerings. In clawback offerings, underwriters or institutional investors are allotted securities, subject to the right of shareholders to "claw back" their rights of subscription. In clawback offerings no separate market for the rights themselves develops. Clawback offerings are often utilized when the subject securities are in bearer form and communication with shareholders is effected through newspaper publication.

(ii) SEC Proposals Relating to Rights Offerings by Non-United States Companies. The SEC has issued a proposal to facilitate the extension of rights offerings made by "foreign private issuers" to United States shareholders. A "foreign private issuer" is defined as any foreign issuer other than a foreign government except an issuer meeting the following conditions: (1) more than 50% of the outstanding voting securities of such issuer are held of record by residents of the United States; and (2) any of the following: (x) the majority of the executive officers or directors of the issuer are United States citizens or residents, (y) more than 50% of the assets of the issuer are located in the United States or (z) the business of the issuer is administered principally in the United States. The proposal encompasses a small issue exemption from the registration provisions of the Securities Act of 1933 ("1933 Act") pursuant to a new Rule 801 and a new Form F-11 registration statement for offerings exceeding the small issue exemption threshold which will allow the use of documents prepared pursuant to the issuer's home jurisdiction disclosure requirements. It must be kept in mind that unless and until the proposal is adopted pursuant to final rule-making of the SEC, the proposal will not have the force of law. There has been no action on the proposal as of this printing.

(iii) Effect on Other Laws. The above proposals will have no impact on the anti-fraud or civil liability provisions of the Federal securities laws. Exemptions from state blue sky laws for rights offerings may be available under a number of possible bases. Offerings will have to be examined on a case-by-case basis to determine whether such exemptions are available.

3. Assumption or retention of the acquired company's indebtedness.

4. Retention by seller of liquid or other assets to reduce purchase price; this retention includes (subject to complex Federal rules) the possibility of using surplus assets from overfunded employee benefit plans of the target.

5. Post-closing sales of assets by acquiror to reduce acquisition indebtedness.

6. Seller financing.

(a) Deferred payment provisions and installment sale transactions.

(b) Rollover of existing stock ownership for stock of the acquisition company.

B. Earn-Outs.

1. Contingent purchase price determination based on future performance.

(a) Formula used to define future performance that gives rise to contingent price.

(b) May be coupled with an escrow of cash or shares.

(c) May be used to defer payment of purchase price.

(d) Rule 144 holding period generally not extended by virtue of contingency.

(e) May enable seller and buyer to reach agreement on a price where there is disagreement on target's potential.

2. Problems.

(a) Development of a formula and the choice and definition of a standard (net worth, net income, gross income, net sales, gross sales), as well as accounting principles and other procedures for computing and verifying performance.

(b) May prevent acquiror from integrating target during earn-out period.

(c) Extent to which acquiror may employ or change:

(i) charges against income, including intercorporate transactions and allocations;

(ii) reserves;

(iii) sales techniques;

(iv) recognition of income;

(v) commitment and cost of capital;

(vi) tax elections; and

(vii) general and administrative expense.

(d) When maximum not earned, disputes may result.

(e) Difficulty when a related business is acquired or when a portion of the target is divested during earn-out period.

(f) Conflict of interest where seller stays on to run business during earn-out period.

(g) Kick-out clauses:

(i) right to abandon business;

(ii) right to terminate target's management; and

(iii) a cap on the earn-out permits the acquiror to buy its way out of disputes.

(h) IRS may impute interest (recharacterizing a portion of the purchase price as such) at a variable statutory rate unless interest is provided for on deferred purchase price at least at such rate.

C. Regulatory Restrictions.

1. Regulation T. Pursuant to Regulation T of the Board of Governors of the Federal Reserve System (the "Board"),

(a) Extending Credit. A broker or dealer may not extend credit if such credit is for the purpose of purchasing, carrying or trading in securities – a "purpose credit";

(i) is not secured by securities which are either:

A. margin securities, including:

1. securities registered on a national securities exchange, and

2. securities on a list of widely traded stocks prepared by the Board; or

B. exempt securities pursuant to the 1934 Act;

(ii) is so secured, but is in an amount in excess of a specified percentage (currently 50%) of the loan value of the margin securities or the good faith loan value of exempt securities.

(b) Arranging Credit.

(i) A broker or dealer may not arrange for the extension of credit except:

A. on such terms as it could extend the credit itself;

B. on terms which do not violate Regulations U (see V.C.2 below) or G and the arranging results solely from investment banking services being rendered by such broker or dealer or the sale of non-margin securities if the sale is exempt from the registration requirements of the 1933 Act by reason of Sections 4(2) or 4(6) therein;

C. where the credit is extended by a foreign person to purchase foreign securities; or

D. a subsequent loan or advance or a face-amount certificate as permitted under 15 U.S.C. Section 80A-28(d).

(ii) A broker or dealer may underwrite a public offering of securities (other than certain equity securities with installment or other deferred-payment provisions) without being deemed to have "arranged" an extension of credit thereby.

2. Regulation U.

(a) Regulation U of the Board generally prohibits a bank from extending any credit secured directly or indirectly by any margin stock for the purpose of purchasing or carrying any margin stock (or refunding or refinancing any indebtedness originally incurred for such purpose) in an amount exceeding the maximum loan value prescribed from time to time for collateral securing the credit. Margin stock currently has a maximum loan value of 50% of its current market value. Other collateral has a loan value as determined by the bank in good faith.

(b) "Margin stock" is defined in Regulation U to include any equity security (or debt security convertible into equity) listed on a national securities exchange or included in the Board's list of over-the-counter stocks, which includes stocks traded in the OTC market which have the requisite high level of distribution and investor interest.

(c) The Board has interpreted the provisions of Regulation U dealing with indirect security for a purpose loan to include arrangements such as a negative pledge clause. However, a negative pledge clause covering all of a borrower's assets will not trigger Regulation U's loan value requirements unless more than 25% of such assets consist of margin stock.

(d) Unlike Regulation T, which contains a maintenance requirement for collateralization of loans subject to its provisions, Regulation U only prohibits the substitution and withdrawal of collateral for a purpose loan if the loan would not be properly collateralized after the substitution or withdrawal.

(e) Like Regulation T, Regulation U prohibits a bank from "arranging" any credit which could not be extended by the bank itself under the provisions of Regulation U.

(f) Regulation U regulates only loans for the purpose of purchasing or carrying margin stock, as defined (or refundings or refinancings of such loans), and then only if the loans (or such refundings or refinancings) are secured directly or indirectly by margin stock. If the loan would not meet the margin requirements, banks may consider deferring taking a pledge of target stock until the acquisition is consummated and the stock is delisted, i.e., is no longer margin stock. Additionally, if at the time of a refunding or refinancing the stock being purchased or carried has ceased to be margin stock, the refunding or refinancing would no longer be subject to Regulation U.

(g) A bank would not be prohibited under Regulation U from extending unsecured credit (or credit secured solely by non-margin stock collateral) for the purpose of purchasing or carrying margin stock, nor would a bank be prohibited from extending a loan secured by margin stock for the purpose of purchasing or carrying a speculative stock which did not constitute margin stock.

VI. AMERICAN DEPOSITARY RECEIPTS.

A. Attributes. An ADR is a certificate, or receipt, which represents a specified number of the underlying securities of a foreign issuer. ADRs are issued by a United States bank (a "depositary") with whom the underlying securities are deposited. The depositary appoints a custodian (located in the foreign issuer's country of incorporation) to hold the deposited securities. ADR prices are quoted in U.S. dollars, and dividends and interest on the underlying securities are converted by the depositary and are paid out in U.S. dollars. ADRs may be issued in connection with a new issue of the underlying security in public offerings (including exchange offers) or in private placements. ADRs can also be established to facilitate secondary market trading without any concurrent issuance of the underlying security. ADRs may be listed with the New York Stock Exchange (the "NYSE") or the American Stock Exchange ("AMEX"), quoted by the Nasdaq Stock Market ("Nasdaq"), or traded on the Nasdaq OTC Bulletin Board system or as "pink sheet" securities. As global offerings have become more common, it has become customary to establish tranches of shares taking the form of ADRs for an offering in the United States and Global Depositary Receipts ("GDRs") or International Depositary Receipts ("IDRs") for offerings in other countries outside the home jurisdiction of the issuer.

B. Types of ADR Facilities.

1. Unsponsored ADR Facilities. Unsponsored ADR facilities are established unilaterally by a depositary, usually in response to investor or broker interest. In some cases, duplicative unsponsored ADR facilities with respect to the same securities of a foreign issuer may exist. Although as a technical matter a depositary may unilaterally establish an unsponsored ADR facility, practically speaking it must have the cooperation of the issuer of the underlying securities, as the ability of the depositary to register ADRs on a Form F-6 registration statement is predicated on the issuer either being subject to the reporting provisions of the 1934 Act, or exempt pursuant to Rule 12g3-2(b) thereof. It is typical for holders of unsponsored ADRs to bear the costs of unsponsored ADR facilities.

2. Sponsored ADR Facilities. Sponsored ADR facilities are created jointly by a foreign issuer and a depositary. Upon the establishment of a sponsored ADR facility, unsponsored facilities with respect to the same securities will need to be terminated. The SEC staff has taken the position that an unsponsored program may not co-exist with a sponsored program for the same securities. The existence of an unsponsored ADR program may therefore be an obstacle to an issuer who would like to establish a sponsored ADR program. This will often require the negotiation of cancellation fees with the depositaries of the unsponsored programs. Depending upon the number of ADRs outstanding, the cancellation fees can be substantial and are typically borne by the issuer, or by the depositary of the sponsored program. The foreign issuer and the depositary enter into a deposit agreement which governs their rights and responsibilities and those of the holders of ADRs. Typically, the foreign issuer will bear some or most of the costs of a sponsored facility, depending on the "level" of the program being implemented (see below). Sponsored ADR facilities are often referred to as being one of three "levels," which correspond to the degree of foreign issuer involvement, amount of public information made available and whether new capital is being raised by the issuer:

(a) Level 1. Level 1 ADRs trade only on the over-the-counter market (i.e., "pink sheets") and are not listed with NYSE or AMEX or quoted on Nasdaq. The foreign issuer will seek an exemption from the reporting requirements of the 1934 Act pursuant to Rule 12g3-2(b) thereof (see VI.D.1.b.ii below);

(b) Level 2. Level 2 ADRs are listed with NYSE or AMEX or are quoted on Nasdaq but do not involve a public offering of the underlying securities (i.e., when new capital is not being raised). Periodic disclosure obligations under the 1934 Act will also arise for issuers on the establishment of Level 2 ADR facilities; and

(c) Level 3. Level 3 ADRs are listed with NYSE or AMEX or are quoted on Nasdaq and involve a public offering of the underlying securities (i.e., new capital is being raised). Periodic disclosure obligations under the 1934 Act will also arise for issuers upon the establishment of Level 3 ADR facilities.

C. Advantages. The establishment of an ADR facility may be advantageous to a foreign issuer for a number of reasons:

1. Because United States investors often favor ADRs over securities of a foreign company, ADRs can prove useful in the context of an exchange offer when a foreign acquiror intends to use its own stock as consideration for the acquisition of a United States public company.

2. An ADR facility can prove an attractive vehicle for stock ownership in a foreign company in cases in which a foreign acquiror wishes to incentivize the employees of a company on a post-acquisition basis through the use of stock option and other employee benefit plans.

3. A foreign acquiror may wish to utilize the ADR vehicle as a means of raising capital in the United States to fund a United States acquisition or for other corporate purposes.

4. ADRs provide a mechanism for investors to receive dividends in U.S. dollars.

5. Issuers may benefit from the enhanced liquidity that a listing in the U.S. (such as the NYSE or Nasdaq) may bring.

6. Some U.S. investors may only be permitted to invest in U.S. dollar denominated securities under the terms of their organizational documents.

D. Legal requirements.

1. Use of ADRs in an Exchange Offer or Other Public Offering.

(a) 1933 Act Requirements. ADRs and the underlying securities with respect thereto are considered separate securities for Federal securities law purposes and both must be registered under the 1933 Act.

(i) ADRs are registered by the filing and effectiveness of a Form F-6 registration statement. The Form F-6 consists largely of the ADR certificate and the deposit agreement among the foreign issuer, the depositary, and the holders from time to time of the ADRs, which governs the rights and obligations of the parties with respect to the ADRs (e.g., the payment of dividends).

(ii) The underlying securities are registered by the filing and effectiveness of, in the case of an exchange offer, a Form F-4, and, in the case of a public offering for cash, either a Form F-1, F-2 or F-3 registration statement. These forms require information on the issuer and the underlying securities, including a description of the business of the issuer (including a requirement to reconcile certain figures with United States generally accepted accounting principles ("GAAP")) and other requirements as to financial statements, and a discussion and analysis of the company's operating and financial review and prospects (commonly referred to as the "MD&A"). (In the case of the establishment of an employee benefit plan, a short Form S-8 registration statement would be utilized.)

(b) 1934 Act Requirements.

(i) Forms 20-F and 6-K. The listing of ADRs on an exchange or Nasdaq (i.e., a Level 2 ADR program) will require the filing of an initial registration statement on Form 20-F and thereafter annual reports on Form 20-F. Form 20-F calls for information similar to that required by a registration statement on Form F-1 (see above). Unlike a domestic issuer, a foreign issuer is not required to file quarterly reports. However, the issuer is required to furnish reports on a Form 6-K containing material information which it makes public in its home country or files with the stock exchange on which its securities are traded, or otherwise distributes to its securityholders.

(ii) Rule 12g3-2(b) Exemption. If ADRs are not to be offered publicly and will not be listed or quoted (i.e., Level 1 ADR program), a foreign issuer must apply for an exemption from the reporting requirements of the 1934 Act. If the exemption is granted, the foreign issuer must furnish to the SEC copies of all material information that the issuer makes public in accordance with the laws of its home country, files with a stock exchange on which its securities are traded, or otherwise distributes to its securityholders.

2. Use of ADRs in a Private Offering. A foreign issuer may wish to raise capital from institutional investors by effecting a private placement by using one of a number of exemptions, including Rule 144A under the 1933 Act. However, Rule 144A may not be utilized for securities which are listed on NYSE or AMEX or quoted on Nasdaq. (See XV.) An exemption from registration for securities issued pursuant to employee benefit plans may be available pursuant to Rule 701 under the 1933 Act.

VII. DUE DILIGENCE – IDENTIFICATION OF EXISTING AND CONTINGENT LIABILITIES.

A. Purpose. An acquiror often considers it commercially prudent as well as consistent with its board of directors' fiduciary obligations to undertake a "due diligence" investigation of the target's books and records and to evaluate its affairs, as promptly as possible, in connection with a proposed acquisition.

B. Participants. It is important to coordinate an investigation to be undertaken by the acquiror's business and financial personnel, independent accountants, counsel, and other appropriate specialists (e.g., actuaries, intellectual property counsel, title companies, engineers, information systems technicians, environmental engineers, appraisers and insurance brokers). Written reports from each such specialist, including a summary of legal and business issues, may be advisable, depending on the complexity of the transaction, prior to finalizing the transaction's structure.

C. Objectives.

1. To evaluate target's business and financial strengths and weaknesses.

2. To enable drafting and negotiation of appropriate representations, warranties and indemnification to deal with areas of special concern.

3. To evaluate exposure to existing and contingent liabilities (including environmental and product liabilities).

4. To evaluate accounting systems and controls and consistency of target's application of GAAP with that of acquiror.

5. To evaluate products, proprietary rights, and research and development.

6. To identify and evaluate legal and contractual impediments to completion of the proposed acquisition, including required authorizations, consents and approvals.

7. To determine whether the information contained in the acquisition agreement and related documentation is consistent with the corporate records and other documents of the target and to confirm that such records and documents do not indicate that information important to an informed acquisition decision has been omitted from the acquisition agreement and related documentation.

D. Timing.

1. It is strongly recommended that the investigation be undertaken before the structuring of a transaction and the signing of a definitive agreement.

2. Where the investigation is undertaken after signing and before closing, a specific condition to such closing should be negotiated to permit termination or revision of the agreement in the event the investigation reveals significant adverse conditions.

3. Where secrecy is desirable, the execution of a confidentiality agreement may be advisable prior to conducting the investigation. Sometimes it is appropriate to structure a limited investigation to be conducted off the target's premises. Where a bidding or auction process is in effect, the management and counsel of the target should conduct the auction or bid with procedures designed to ensure fairness to all potential acquirors, granting equal time and access for due diligence examination of records and interviews with management and other employees. In the event that the management of the target is

itself participating in one of the bidding groups, it may be necessary for other bidders to insist upon formal procedures to ensure the opportunity for a meaningful due diligence investigation.

E. Review by Counsel. Legal counsel should review the entire legal and corporate structure of the target as well as the corporate law of the state of incorporation of the target in an effort to identify any significant "downside" risks. Set forth below is a list of some of the significant categories to consider. This list, however, is intended to be a guide rather than a comprehensive list. Every due diligence investigation should be a complete and exhaustive examination of the target, specifically tailored to the target under consideration.

1. Basic corporate documents:

(a) charter documents and all amendments thereto;

(b) by-laws and all amendments thereto;

(c) stock books, stock transfer ledgers and stockholder agreements;

(d) minute books for meetings of stockholders, board of directors and important committees (e.g., executive and audit committees);

(e) good standing certificates from state of incorporation and from states of foreign qualification; and

(f) partnership or joint venture documents.

2. Material contracts, agreements, commitments and leases should be reviewed for:

(a) assignability;

(b) validity;

(c) representations, warranties and covenants;

(d) onerous or unusual provisions, including liability/indemnity provisions;

(e) breaches or defaults;

(f) redetermination or escalation clauses; and

(g) term and termination.

3. Complete list of any existing, threatened or potential actions, suits and governmental or regulatory proceedings and pending or threatened proceedings or investigations, and all documentation and correspondence relating thereto.

4. Employment policies and personnel, including review of all employee benefit plans, policies, contracts with employees, labor history, the Occupational Safety Health Act of 1970, as amended ("OSHA") and worker's compensation history and discrimination claims.

5. Compliance with appropriate statutes and agency guidelines, including:

(a) OSHA and all regulations promulgated thereunder;

(b) Environmental Protection Act and state and local regulations;

(c) ERISA;

(d) Equal Employment Opportunity Act of 1972;

(e) labor practices;

(f) special requirements for regulated industries;

(g) The Age Discrimination in Employment Act of 1967, as amended; and

(h) Title VII of the Civil Rights Act of 1964, as amended.

6. Permits, licenses, regulations and other governmental authorizations.

7. Federal, state, local and foreign tax returns.

8. Antitrust considerations:

   (a) pending or threatened private and governmental actions;

   (b) agreements with or requests by the Federal Trade Commission (the "FTC") concerning the target or its assets; and

   (c) consents, decrees or existing orders with respect to pricing, policy disposition or requisitions.

9. Patents, trademarks, copyrights, trade secrets and other proprietary information held or used by the company.

10. Real property (owned and leased), valuation and marketability of title.

11. All insurance policies, outstanding claims and agreements relating to indemnification.

12. Environmental:

   (a) all environmental permits, licenses, registrations and other authorizations and all applications thereof;

   (b) all environmental studies and reports within the last five years;

   (c) all reports, manifests, regulatory filings and other documents relating to hazardous waste or management over the last five years;

   (d) all documents relating to contamination, clean-up or remediation on-site or off-site, or spills or releases;

   (e) all documents relating to PCB equipment and asbestos existence or exposure; and

   (f) all correspondence with and notices to and from any regulatory authorities.

13. Financial statements and reports.

14. Appraisals and other reports prepared by management.

15. Prospectuses, offering circulars and SEC reports or filings.

16. Security interests (such as those evidenced by Uniform Commercial Code ("UCC") financing statements) on any real, personal or intangible property.

17. All evidence of indebtedness for borrowed money or indebtedness created by guaranties of contract performance.

18. Interested party transactions, including all payments made to or from affiliates, directors and officers.

19. All marketing or business plans.

VIII. <u>TIMING.</u>

A. <u>Friendly Transactions.</u>

1. Structure, required regulatory approvals and consideration are principal elements affecting the time required to complete an acquisition.

2. Cash transactions can generally be closed in less time than transactions involving the issuance of securities by the acquiror or its parent. A cash tender offer could be completed in as little time as one month.

3. Factors affecting timing include:

(a) merger or acquisition of substantially all assets will require the target's stockholders' vote, requiring usually at least 20 days' notice per applicable state law or the target's by-laws (unless unanimously waived by the stockholders);

(b) where the target is publicly held, the vote of stockholders requires preparation and clearance with the SEC of proxy material which takes approximately 30 days if proxy material is not reviewed. If reviewed, at least 30 additional days could be required;

(c) if the acquiror or the parent must register securities, a registration statement must be prepared, filed and become effective (minimum 45 days; usually at least 30 days from date of filing unless a simplified registration form can be used);

(d) in a leveraged acquisition, a minimum of 90 days must be allowed for negotiation of debt and equity financing agreements; appraisals, real property surveys, title reports and environmental audits normally will be required;

(e) Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act") filings, if required (see XVI below); and

(f) approvals or consents by regulatory commissions or agencies, if necessary.

B. Unfriendly Transactions.

1. Timing can be largely determined by the target's board of directors which can prevent consummation of a deal by means of a poison pill or while an alternative transaction is being negotiated. A proxy contest or lawsuit with respect to the fiduciary duty of directors can be used to circumvent an intransigent board of directors.

2. High likelihood of litigation.

3. Protracted hearings and other proceedings before regulatory commissions or agencies may cause delays.

4. If the transaction must be consummated during the pendency of a control contest without ever reaching a negotiated arrangement with the target's Board of Directors, at least six months and in some cases more than a year will be required depending on the legal and procedural delays encountered.

IX. TENDER OFFERS.

A tender offer, in which an acquiror makes an offer to purchase stock directly to a target's shareholders, is primarily regulated by the Williams Act (sections 13(d) and (e) and sections 14(d), (e) and (f) of the 1934 Act). Where the consideration offered for the purchase consists entirely or in part of the securities of the tendering company (an "exchange offer"), the offeror may also have to comply with the registration requirements of the 1933 Act.

A. Federal Law.

1. In October 1999, the SEC issued two major releases (the "M&A Release" and the "Cross Border Release") affecting tender offers. Effective January 24, 2000, the new and revised rules promulgated by the M&A Release significantly liberalized communications with shareholders and the public surrounding a tender offer, leveled the playing field between cash tender offers and exchange offers by allowing for early commencement in the latter and made substantial changes to other tender offer procedural rules and disclosure requirements. Effective the same date, the Cross Border Release created two tiers of exemptions from the 1933 Act and the 1934 Act rules for foreign private issuers in cross-border tender and exchange offers. These changes are incorporated and summarized below.

2. Williams Act–Section 14. Pursuant to Rule 14d-3 under the 1934 Act, as soon as practicable on the date of the commencement of a tender offer a Schedule TO must be filed with the SEC, the target, and

any other bidders and notice of the tender offer given to each market in which the target's securities are traded.

(a) A tender offer is deemed "commenced" when shareholders are provided with a means to tender their shares into the offer. While other public or shareholder communications surrounding a tender offer must be filed with the SEC under a Schedule TO, such communications no longer trigger commencement.

(b) The M&A Release adopted Regulation M-A as a new subpart of Regulation S-K to govern the disclosure requirements for tender offers and other business combination transactions. Schedule TO, located under Regulation M-A, provides for disclosure of pre-commencement communications, notice of commencement and amendment or supplementation of information regarding a tender offer.

(c) Schedule TO requires certain disclosures concerning the offeror and related persons, including:

(i) a summary term sheet in plain English, outlining the material terms of the tender offer;

(ii) the identity and background of the target company, the title and number of outstanding shares of the class of securities subject to the tender offer, the principal market on which those securities are traded and historical price information;

(iii) the identity and background of the offeror and all controlling persons and all of their directors and executive officers (including those of the offeror's parent) (e.g., material occupations for the last five years, any criminal convictions in the last five years, any securities law violations);

(iv) the material terms of the tender offer, including number of shares sought, consideration being offered, scheduled expiration date and possible subsequent offering periods or extensions, withdrawal periods, procedures for tendering and withdrawing, periods for pro-rata acceptance of tendered securities, differences in the rights of holders and Federal income tax consequences;

(v) a detailed description of certain past contacts, transactions or negotiations by the offeror with the target and certain of its affiliates, officers and directors, or agreements involving the target's securities;

(vi) a detailed description of the purpose of the tender offer and any specified plans or proposals which the offeror may have regarding the target;

(vii) the offeror's sources of funds, including the amount of funds required to purchase the maximum amount of securities sought in the offer, material conditions to financing and details relating to any loan being used in connection with the offer (with a copy of any loan agreement filed as an exhibit);

(viii) the offeror's current ownership of securities of the target and a detailed description of transactions in the subject class of securities in the 60 days prior to the offer;

(ix) the identity of any persons retained, employed or to be compensated by the offeror to solicit tenders in connection with the offer;

(x) if material, financial statements of the offeror (or, in the case of a subsidiary formed for the purpose of making the offer, its parent). Schedule TO specifies that financial statements are not material in the case of an all-cash tender offer not subject to financing conditions and where either the offeror is a public reporting company under the 1934 Act or the offer is for all outstanding securities; and

(xi) certain other information which would be material to stockholders of the target.

(d) The tender offer is required to remain open for at least 20 business days (or if the tender offer involves a roll-up transaction and the securities being offered are registered on Form S-4 or Form F-4, for at least 60 calendar days) and, in the event of an increase or decrease in the tender offer price or percentage of stock sought, for at least 10 business days from the date of the giving of notice of the change. The minimum period of time that a tender offer must remain open in the event of other material changes depends on the particular facts and circumstances, although at least five business days from the date of the change is generally advisable. Required extension periods for exchange offers are summarized below.

(e) Tendering stockholders have the right to withdraw their shares until termination or withdrawal of a tender offer.

(f) Where the tender offer is for less than all of the outstanding securities of the target and where a greater number of such securities are deposited pursuant to the tender offer, the securities must be purchased pro rata.

(g) The tender offer must be open to all security holders of the subject class.

(h) Where the offeror varies the terms of the tender offer before the expiration thereof by increasing the offered consideration, the offeror must pay the increased consideration to all security holders who have tendered.

(i) In the case of an offer for all outstanding shares, upon acceptance of and prompt payment for all shares tendered during the initial offering period an offeror can add a subsequent offering period after the expiration of the initial offering period. No withdrawal rights are available during this period, which must begin on the business day following expiration and extend for a minimum of 3 and maximum of 20 business days, and the same amount and form of consideration must be paid for additional shares tendered. Rule 14d-11 details additional requirements for this subsequent offering period.

(j) Rule 14d-5 details procedures for obtaining the list of stockholders and the dissemination of tender offer information to stockholders.

(k) Pursuant to Rule 14e-2, the target must issue a statement of its position on the tender offer (recommending acceptance or rejection, remaining neutral or stating that it is unable to take a position) within 10 business days after the announcement of the offer. The statement must conform to SEC rules, including the filing of a Schedule 14D-9.

(l) The M&A Release replaced Rule 10b-13 with new Rule 14e-5 governing purchases outside of a tender offer. Such purchases can be made only if they were contractually arranged before announcement or after expiration of the tender offer, or if the contract for purchase made during the pendency of the offer is unconditional and binding on both parties, and terms of the contract are disclosed. Such purchases during a subsequent offering period must be for the same amount and type of consideration as offered in the tender offer.

(m) In conjunction with the liberalized communications rules, the M&A Release adopted Rule 14e-8 as a new anti-fraud rule, prohibiting the announcement of a tender offer without the intent to commence and complete the offer within a reasonable amount of time and with a reasonable belief that an adequate source of funds for purchase exists, or with the intent to manipulate the target stock price.

(n) Any transaction in target securities by any person who has received non-public information of a proposed tender offer "directly or indirectly" from the potential offeror is prohibited unless the information and its source are publicly disclosed within a reasonable time before the transaction. An offeror may not communicate any such non-public information to any person likely to violate such trading restrictions.

3. Additional Requirements for Exchange Offers. The M&A Release made substantial alterations to bring the treatment of stock tender offers, or exchange offers, in line with that of all-cash tender offers. In addition to requiring compliance with the 1933 Act for registration of any securities to be offered as consideration in a tender offer, exchange offers differ from the above tender offer procedures in the following respects:

   (a) Early commencement is permitted upon filing of a registration statement under the 1933 Act, rather than upon effectiveness of the statement, allowing the offeror to choose the commencement date. The exchange offer is deemed commenced upon filing of the registration statement and Schedule TO with the SEC, and by delivery of a fairly complete preliminary prospectus and letter of transmittal to security holders. Early commencement is not available for going-private or roll-up transactions.

   (b) Securities can be tendered into the offer after early commencement, but the offeror can not accept shares until the registration statement is declared effective and the tender offer has expired.

   (c) Disclosure requirements for exchange offers differ from those required in tender offers as follows:

      (i) The preliminary prospectus used for commencement must include all information which would be required by an investor to make an informed decision about tendering, including price information. Rule 430 and 430A exclusions under the 1933 Act are not permitted. Any material changes to the information in the preliminary prospectus requires dissemination of a supplement, and extension of the offer as described below. A final prospectus must be filed with the SEC, but generally not disseminated to the target's shareholders.

      (ii) If a prospectus supplement contains any material change other than with respect to share or price levels, the offer must remain open for at least 5 business days following the dissemination of the supplement; changes in price, shares sought, dealer's soliciting fee or other significant changes require 10 additional business days, as does a prospectus supplement included as a post-effective amendment to the registration statement; if the initial preliminary prospectus filed with the SEC is materially deficient, the offer must remain open for at least 20 business days from filing and dissemination of a revised prospectus.

      (iii) The M&A Release takes the position that target financial information is not required where the target's security holders will vote on a transaction in which the consideration consists solely of acquiror securities exempt from registration.

4. Williams Act–Section 13(d). Section 13(d) of the 1934 Act requires disclosure by any person or "group" (i.e., two or more persons acting together) acquiring "beneficial ownership" of over 5% of any class of registered equity securities.

   (a) A Schedule 13D must be filed by the purchaser or group within 10 days after acquiring, directly or indirectly, more than 5% of an outstanding class of equity securities of the issuer. The Schedule 13D must be filed with the SEC, the issuer, and any stock exchange or market on which the security is traded or quoted and must disclose, among other things, the following information:

      (i) the purchaser's identity and background (where a corporation is the purchaser, information must be furnished relating to the purchaser's executive officers, directors and all controlling persons, including its parent, and the executive officers and directors of the ultimate controlling entity);

      (ii) the amount and source(s) of the funds for the purchase(s);

(iii) the purpose of the purchase(s) and any plans or proposals with respect to extraordinary corporate transactions involving the target;

(iv) the number of shares owned by the purchaser or group and transactions in the shares during the prior 60 days; and

(v) any contracts, arrangements or understandings with others with respect to the securities of the target.

(b) An amendment to Schedule 13D must be filed promptly to report any material change in the facts set forth in the previous filing, including material increases or decreases in the percentage of the class owned. An acquisition or disposition of 1% or more of the class is deemed "material," subject to the exception that an acquisition which, together with all other acquisitions during the preceding 12 months, does not exceed 2% is exempt. Acquisitions of less than 1% may be deemed material under certain circumstances.

(c) Certain institutional holders may file a Schedule 13G rather than a Schedule 13D. Schedule 13G requires considerably less disclosure than Schedule 13D and must be filed within 45 days after the end of the calendar year in which the person became obligated to file. Certain institutional holders which have filed a Schedule 13G with the SEC may amend such Schedule within 45 days after the end of each calendar year to reflect acquisitions or dispositions of an issuer's securities rather than filing upon the occurrence of such transactions. If, however, such holder acquires 10% or more of an issuer's securities, it must make a filing within 10 days after the end of the month in which the 10% threshold was reached and must thereafter file within 10 days of the end of any month in which such holder's beneficial interest increases or decreases by more than 5%. A stockholder with over 5% of a class of equity securities of an issuer may also use Schedule 13G rather than Schedule 13D if it owns less than 20% of the class and has not acquired the securities with a change of control purpose. These filers must amend their filing showing any changes within 45 days of the end of the calendar year, and must file an amendment promptly after exceeding 10% ownership or increasing or decreasing their position by more than 5%.

(d) Should a passive institutional or individual holder who has previously filed a Schedule 13G decide to become active – to acquire or hold the securities not just for purposes of investment, but with intent to change or influence control of the issuer – then that holder must within 10 days of its change in purpose file a Schedule 13D, and must refrain from voting or acquiring additional interests in the issuer for 10 days following that filing.

(e) The M&A Release revised Rule 13e-1 governing issuer repurchases during the pendency of a third-party tender offer to exclude ordinary-course periodic repurchases in connection with employee benefit plans and to provide that required disclosure of information about the intended repurchases be filed with the SEC, but not disseminated to security holders.

5. Other Relevant Laws.

(a) Despite the liberalization of tender offer communications, all liability and antifraud rules still apply, including Rule 10b-5, and are augmented by the new tender offer antifraud provision in Section 14(e) and the new tender offer inside information prohibition in Rule 14e-3. In a recent interpretation of the new tender offer antifraud rules, the Ninth Circuit court of appeals held that a shareholder alleging insider trading liability under Rule 14e-3 would have to comply with the same standing requirements as were generally applied under Rule 10b-5, namely that they must have traded contemporaneously with a company conducting a public market buyback while considering a third-party tender offer. Brody v. Transitional Hospitals Corp., 9^{th} Cir., No. 99-15672, 2/7/02.

(b) Issuer tender offers are subject to Rule 13e-4 of the 1934 Act, and the rules promulgated thereunder. Issuers must file a Schedule 13e-4 with the SEC to conduct a self-tender offer.

(c) Tender offers by issuers or affiliates which result in a "going private" transaction are subject to the filing and reporting requirements of Rule 13e-3 under the 1934 Act. (See XIII.F.3(a) and XV below.)

(d) Rule 10b-18 restricts certain purchases of an issuer's common stock by the issuer or its affiliates. The rule restricts, among other things, (i) persons through whom such purchases may be made, (ii) the timing of the purchases, (iii) the price at which such purchases may be made, and (iv) the volume of shares which may be purchased.

B. <u>Pre-Offer Purchases and Definition of Tender Offer</u>.

1. <u>Pre-Offer Purchases</u>.

(a) Under Section 13(c) and Regulation 13D-G, an offeror may acquire up to 5% of a class of a target's securities in open market and privately negotiated transactions (or more, if the additional amount is acquired within 10 days of reaching 5%) without filing a Schedule 13D and without otherwise disclosing its intentions or plans.

(b) The advantages of an offeror making such purchases prior to the initiation of a tender offer include the following:

(i) the target's management may be influenced by the offeror's financial commitment;

(ii) other bidders may be deterred; and

(iii) if another party purchases such securities of the target at a higher price (by submitting a higher bid, for example), the offeror will profit on its initial position in the securities and thereby cover some of the expenses of an unsuccessful bid. (Note, however, that if the unsuccessful tender offeror, who purchased stock after it owned more than 10% of the target or who is an officer or director, sells the target's stock it has acquired less than 6 months after purchase and before consummation of a merger (between another party and the target), liability under Section 16(b) of the 1934 Act would result and any profit on the sale is recoverable by the target. Such Section 16(b) liability may be avoided in instances where there is no possibility for speculative abuse of inside information by the tender offeror, and the unsuccessful tender offeror involuntarily surrenders or exchanges the target's stock pursuant to a merger. However, where the unsuccessful tender offeror voluntarily negotiates a surrender or exchange of the target's stock, Section 16(b) liability will attach.)

(c) The problems of an offeror seeking a preliminary position include the following:

(i) such purchases may subject the offeror to Schedule 13D filing obligations and other disclosure requirements;

(ii) HSR Act filings may be required;

(iii) even in the absence of 13D disclosure requirements, such purchases may practically result in premature disclosure of the offeror's intentions to commence a tender offer;

(iv) such purchases could put upward pressure on the market price and, by extension, the tender offer price;

(v) a series of purchases could be deemed to be a tender offer under certain circumstances; and

(vi) if no transaction for the target were consummated, the market value of the purchased stock could drop precipitously.

2. <u>Problems in Defining Tender Offers</u>.

(a) Neither the Williams Act legislation, nor the SEC's implementing rules define the term "tender offer." In fact, in their introductory comments to Regulation 14D in 1979, the SEC expressly declined to define the term, believing that flexible interpretation in line with the purpose of the Williams Act was preferable. While in late 1979 and early 1980, the SEC indicated a potential change in this position and went so far as to propose an amendment to the Williams Act to include a definition, no such amendment was effected. Despite the sweeping changes to the tender offer rules introduced in 2000, no definition has yet been supplied by either the legislature or the SEC.

(b) Factors which have been identified by the courts and the SEC as relevant to, though not controlling of, a determination of whether a transaction is a tender offer, which factors have been applied by the courts in varying degrees, include the following:

(i) whether there is an "active and widespread solicitation" of public stockholders for shares of an issuer;

(ii) whether the solicitation is made to the holders of a substantial percentage of the target's stock;

(iii) whether the offer to purchase is made at a premium over the prevailing market price;

(iv) whether the terms of the offer are firm rather than negotiable;

(v) whether the offer is contingent on the tender of a fixed minimum number of shares, and perhaps subject to a fixed maximum number to be purchased;

(vi) whether the offer is open for only a limited period of time;

(vii) whether the offerees are subjected to pressure to sell their stock; and

(viii) whether public announcements of a purchasing program concerning the target precede or accompany a rapid accumulation of large amounts of the target's securities.

(c) In Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985), the Second Circuit concluded that a block purchase of approximately 25% of SCM stock by Hanson Trust at $73.50 per share immediately following termination of a tender offer at $72 per share did not constitute an illegal tender offer. Rather than applying the SEC's eight-part test, the Court instead reached its decision by examining the purposes of the Williams Act. It concluded that the class of persons protected by the Williams Act were not injured. The sellers were a relatively small number of sophisticated investors, rather than members of the general public who might otherwise be pressured into unadvised sales. The Court found that, having disclosed the possibility of the termination of its tender offer followed by open-market purchases, Hanson had satisfied the disclosure requirements of the Williams Act. The decision has been criticized since it does not give all stockholders an equal opportunity to sell their shares to the purchaser.

(d) Courts have applied various standards in determining when a tender offer has begun, one of which is the "shareholder impact" test, where the test is whether the offer or solicitation has the same impact on shareholders as would a tender offer, necessitating Williams Act protection and disclosure.

(i) Open market purchases and privately negotiated purchases with publicized intent to acquire control have led to the application of the shareholder impact test.

(ii) Open market purchases without publicized intent, however, have been held not to constitute tender offers, but the SEC has not been willing to take a "no action" position.

(e) Other acquisition activities have been held to not constitute tender offers for purposes of the Williams Act:

(i) privately negotiated purchases from sophisticated investors; and

(ii) large block purchases over a national securities exchange without direct solicitation by the acquiror.

C. State Laws. All but a handful of states have enacted "anti-takeover" legislation aimed at protecting their corporations from hostile takeovers. The first generation of these statutes, enacted in 37 states between 1968 and 1982, was invalidated when the United States Supreme Court struck down an Illinois statute on constitutional grounds. Edgar v. MITE Corp., 457 U.S. 624 (1982). The Supreme Court ruled that the statute violated the supremacy clause of the United States Constitution, and that the disclosure requirements of the Illinois statute were preempted by the Federal Williams Act. A second generation of anti-takeover statutes followed, and in 1987 the Supreme Court upheld the constitutionality of an Indiana anti-takeover statute, ruling that it did not violate either the supremacy clause or the commerce clause of the United States Constitution, and was, therefore, not preempted by the Williams Act. CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987). The Indiana law, a control share acquisition statute, is one of a variety of anti-takeover statutes currently in effect.

1. Business Combination Statutes. These statutes are designed to prohibit an offeror from merging with a target corporation for a specific period of time (usually three to five years), unless (i) the target's board of directors had approved the merger prior to the offeror obtaining a specified percentage of the target's stock, (ii) a supermajority of disinterested shareholders approves the combination, or (iii) certain statutory requirements are met for determination of a "fair price." These second-step mergers are used in conjunction with tender offers to obtain the target's assets and to freeze-out the shareholders that do not tender. Because such a merger is often a necessary predicate for the financing of a leveraged transaction, these statutes have the effect of restricting many hostile offers. By June 1997, 35 states had enacted business combination statutes.

(a) The Delaware Model. Section 203 of the Delaware General Corporation Law ("DGCL") provides that a person who acquires 15% or more of the voting stock of a Delaware corporation (an "interested stockholder") may not effect mergers and certain other business combinations with the target for three years, unless the target's board of directors, prior to the date the acquiror becomes an interested stockholder, approves either the business combination or the transaction that results in the stockholder becoming an interested stockholder. An offeror who does not receive advance board approval may still merge with the target if it can satisfy either of two additional exceptions: (i) the interested stockholder acquires at least 85% of the outstanding voting stock of the target (excluding shares owned by director-officers and certain employee stock plans) in the same transaction in which it becomes an interested stockholder; or (ii) the merger is subsequently approved by the target's board of directors and $66^2/_3$% of the outstanding voting stock that is not owned by the interested stockholder. The Delaware statute does not include a "fair price" safe harbor. Delaware corporations may opt out of the statute by a majority vote of stockholders, as is the case under most states' business combination statutes. In Delaware, the opt-out does not become effective until 12 months after the vote.

(b) The New York Model. Section 912 of the New York Business Corporation Law provides that an acquiror of 20% or more of the stock of a New York corporation (an "interested shareholder") may not merge with the target for five years unless the merger is approved by the target's board of directors prior to the acquisition of stock. After the five-year waiting period, the statute provides the interested shareholder with two alternatives for consummating the business combination. The first alternative permits a combination that is approved by the holders of a majority of the outstanding voting stock, excluding shares beneficially owned by the interested shareholder or its affiliate or associate. The second alternative requires the interested shareholder to pay a fair price to the other shareholders, as defined by a formula in the statute. New York corporations may opt out of the statute by a majority vote of disinterested shareholders, and the opt-out becomes effective 18 months after the date of such vote.

2. Control Share Acquisition Statutes. These statutes restrict the rights and powers of "control shares," typically defined as voting shares that, when aggregated with all other shares of the corporation owned

by the acquiror, exceed a specified threshold of voting power. A person who acquires control shares may not vote until the shares are granted voting rights by a specified percentage of disinterested shareholders (usually a majority) in a special election held to consider the issue. Restrictions placed on a holder of control shares differ under the various state statutes. Most have opt-out provisions. By June 1997, 26 states had enacted control share acquisition statutes; 24 states had both business combination and control share acquisition statutes.

3. Directors' Duties Statutes. At least 30 states have enacted laws permitting corporate directors, in discharging their duties, to consider the long-term and short-term interests of their corporations, the interests of shareholders, as well as a variety of other interests, such as the interests of current and retired employees, customers, suppliers, creditors, local communities, the economy of the state and the nation, and whether those interests would be best served by the corporation remaining independent. The primary purpose of these statutes is to permit directors faced with a hostile offer to consider more than just the price being offered for a corporation's stock by an acquiror, and particularly to consider the interests of constituencies other than the shareholders. For example, in states with business combination statutes, these additional factors would become relevant to directors deciding whether to approve a merger of an interested shareholder with the target. These statutes also make it more difficult for shareholders to prevail in derivative suits against directors who oppose a merger or otherwise thwart a takeover bid.

   (a) The Delaware Rule. In Delaware, a state without a directors' duty statute, the state Supreme Court has held that once a company is for sale, the target's board of directors must seek to obtain the highest price for the stockholders. Revlon v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986). In contrast with states with directors' duties statutes, the rule in Delaware is that "concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect the corporate enterprise, but to sell it to the highest bidder." Id. at 182. See also, Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1993) (Revlon duties triggered when the board agrees to a business combination that would effectively shift voting control from target's public stockholders to acquiror's controlling shareholder).

   (b) If, however, the board's reaction to a hostile offer constitutes only a defensive response to protect the long-term welfare of the company, and not an abandonment of the corporation's continued existence, Revlon duties are generally not triggered.

   (c) Finally, if the board is presented with only a single offer, and it has no grounds to judge its adequacy, it may be required to canvas the market to determine if higher bids may be elicited. Absent any such circumstance, there is no per se duty to maximize stockholder value in the short-term.

4. Fair Value Statutes. At least two states have developed statutes modeled on the appraisal rights available to dissenting shareholders in a merger transaction, whereby an interested shareholder (usually defined as a beneficial owner of 20% voting power) must provide notice of his control position, and offer remaining shareholders payment of "fair market value" for their shares, which value may include a control premium. (Fair value and fair price, terms variously defined in anti-takeover statutes, generally correspond to an amount equal to at least the highest price paid by an acquiror for the target's stock or the highest market value of the target's stock during a specified period.)

5. Anti-Greenmail Statutes. Five states have enacted statutes specifically targeted at preventing a raider from selling its stock back to the target at above-market prices, a practice known as "greenmail." These statutes typically prevent the target from buying a certain percentage of its stock (varying from 2% to 10%) at an above-market price from a shareholder who has owned the shares for less than a specified period of time (ranging from six months to three years), unless the same offer is made to all shareholders or the purchase is approved by a majority of outstanding shares.

6. Mandated Staggered Board Statute. In Massachusetts, domestic public corporations must stagger terms for its board of directors. A statute requires election of no more than one third of the total board each year, and is designed to inhibit an acquiror from obtaining control of a Massachusetts corporation in a proxy contest. Massachusetts corporations may, however, opt out of the requirement at any time with a vote of two-thirds of the outstanding shares.

7. Disgorgement Statutes. In 1990, Pennsylvania enacted the toughest anti-takeover law in the nation, including a business combination statute, a control share acquisition statute, a directors' duties statute and a fair value statute. Also included in the legislative regime is a law that permits Pennsylvania corporations, under certain circumstances, to strip a controlling person of profits made on the sale of that corporation's stock. A controlling person, defined as a person who obtains or attempts to obtain 20% or more of the voting power, must disgorge all profits from the sale of stock that was (i) acquired without the approval of the target's board of directors during the period commencing 24 months prior to and ending 18 months after becoming a controlling person, and (ii) sold within the 18 month period following attainment of controlling-person status. Thus, where a controlling person obtains its share of the target's stock in a hostile effort to take over the corporation, and later sells that position within 18 months (for example, to a successful competing bidder) it must disgorge any profit earned on the subsequent sale of the corporation's stock.

8. Tin Parachutes and Labor Contracts. Five states have enacted legislation providing that collective labor contracts must remain unimpaired, even if a company is sold or merged, unless the parties to a contract or their successors agree otherwise. Several states also require that employees who lose their jobs during a specified period of time either before or after a change in corporate control receive a lump sum severance payment.

9. Management Buyout Statutes. California has adopted a statute to address concerns specific to LBOs by management groups, including conflicts of interest. Management must precede any buyout transaction with (i) a fairness opinion independently appraising the offering price, and (ii) disclosure to shareholders regarding competing offers. The statute governs not only domestic corporations, but also selected foreign corporations doing significant business in California.

10. Poison Pill Endorsement Statutes. A variety of statutes permit corporations to create "poison pill" shareholder rights plans. Rights plans are designed, upon acquisition of what would otherwise be a control share by the would-be acquiror, to dilute the voting power of the acquiror's shares and thus make a takeover attempt less attractive to the acquiror. Corporations accomplish this by creating and issuing rights or options which typically permit shareholders, other than the acquiror, to purchase additional shares of either the target ("flip-in") or the acquiror ("flip-over") at a highly discounted price. Several courts have invalidated flip-in poison pills, finding them necessarily discriminatory because they prevent the acquiror from purchasing shares in the target while enabling the other shareholders to do so as a result of their discriminatory effects. In response, some states, including New York, have enacted laws expressly permitting their corporations to utilize this takeover defense.

D. SEC Rules Relating to Tender Offers, Exchange Offers and Business Combinations Involving the Securities of Foreign Private Issuers.

1. The Rationale for the New Rules. In 1999, the SEC adopted new rules relating to tender and exchange offers and business combinations involving the securities of foreign private issuers. The new rules became effective on January 24, 2000 and provide relief from certain regulatory barriers presented by the U.S. securities laws in order to facilitate the inclusion of U.S. security holders in such transactions. (Similar rules were enacted in respect of rights offerings conducted by foreign private issuers; see Rule 801 under the 1933 Act.) Historically, the acquirers of many foreign companies excluded U.S. shareholders of such companies from participating in takeover transactions, or used "vendor facilities" to prevent such shareholders from receiving shares in the acquiring company in exchange offers, due to U.S. regulatory restraints.

2. <u>Anti-Fraud Rules Still Apply</u>. Significantly, even where the exemptions provided under the new rules apply to a transaction, the transaction will still be subject to the antifraud provisions of the U.S. securities laws.

3. <u>Summary of Tier I/Tier II Rules</u>. In general, the new rules provide for the following exemptions in respect of cross-border tender and exchange offers:

- A "Tier I" exemption provides that third-party and issuer tender offers for the securities of foreign private issuers registered under Section 12 of the 1934 Act will be exempt from most provisions of the Williams Act and rules governing such offers if U.S. security holders hold 10% or less of the subject securities.
- A "Tier II" exemption provides that third-party and issuer tender offers for the securities of foreign private issuers registered under Section 12 of the 1934 Act will be exempt from certain provisions of the Williams Act that often conflict with foreign regulatory requirements if U.S. security holders hold 40% or less of the securities of the subject company.

(a) <u>The "Tier I" Exemption</u>

(i) Under the Tier I exemption, tender offer and "going private" rules will not apply to an issuer or third-party tender or exchange offer if:

A. U.S. security holders hold 10% or less of the securities of the subject company;

B. U.S. security holders participate in the tender offer on terms at least as favorable as those offered to any other security holders, subject to the following exceptions:

> Where securities are offered by a bidder, an exception to the equal treatment requirement provides that the bidder may offer solely cash to U.S. security holders as long as the bidder has a reasonable basis to believe that the cash amount is substantially equivalent to the value of the consideration offered to non-U.S. security holders.

Additional exceptions to the equal treatment requirement provide that, under certain circumstances: (a) in an exchange offer registered under the 1933 Act, a bidder offering securities may exclude security holders of the subject company located in any state that does not exempt offered securities from registration or that refuses to register or qualify the offer and sale of securities in that state after a good faith effort by the bidder to register the securities, and (b) in an exchange offer exempt from registration under Rule 802 of the 1933 Act, a bidder may exclude security holders of the subject company located in those states or jurisdictions that require registration or qualification, located in each case provided that the bidder offers the same cash alternative to security holders of the subject company located in any such state or jurisdiction that it has offered to security holders of the subject company located in any other state or jurisdiction and a bidder may offer a "loan note" alternative solely to non-U.S. security holders.

C. the bidder provides U.S. security holders with the tender offer circular or other offering documents on a comparable basis to that provided to other security holders; and

D. the bidder submits an English language translation of the offering materials to the SEC on Form CB and, in the case of a foreign bidder, files a consent to service of process in the United States on Form F-X no later than the next business day after the tender offer is commenced.

(ii) Tender offers that qualify for the Tier I exemption also will be exempt from Rule 14e-5 (formerly Rule 10b-13) under the 1934 Act, so that, during the pendency of the offer, bidders will be allowed to purchase or arrange to purchase subject securities (including within the United States) outside of the offer if certain required disclosures about the purchases are made and the purchases comply with the applicable tender offer rules of the home jurisdiction.

(b) The "Tier II" Exemption.

(i) Under the Tier II exemption, which represents a codification of pre-existing exemptive and interpretive positions of the SEC, offerors will be entitled to limited relief from the U.S. tender offer rules in order to minimize conflicts between such rules and foreign regulatory provisions. Such relief primarily consists of the following:

A. An entity may divide its offer into two separate offers – one to U.S. security holders which complies with U.S. regulatory requirements and one to non-U.S. security holders which complies with the home jurisdiction's regulatory requirements – if the offer to U.S. security holders is made on terms at least as favorable as those offered to any other holders of the subject securities. Significantly, the "cash only" exception for U.S. security holders under Tier I is not available under Tier II.

B. A bidder may rely on the notice of extensions and prompt payment requirements of the home jurisdiction.

C. A bidder will be allowed to provide for a "subsequent offering period" without withdrawal rights if the bidder announces the results of the tender offer and pays for tendered securities in accordance with the law or practice of the bidder's home jurisdiction and the subsequent offering period commences immediately following such announcement. The bidder will not be required to extend withdrawal rights during the period between the close of the offer and the commencement of the subsequent offering period.

(ii) Tender offers that qualify for the Tier II exemption will still be subject to the procedural, disclosure and filing requirements of the U.S. tender offer rules that would otherwise apply to such offers. To the extent that an offeror needs additional relief from that provided in the Tier II exemption, the SEC has indicated that it will consider applications for exemptions on a case-by-case basis.

(iii) Where the Tier I exemption does not apply, no purchases of the subject securities – other than pursuant to the offer – may be made by the issuer (or affiliates thereof) until the expiration of the offer. However, the SEC will continue to review requests for relief from Rule 14e-5 for tender offers that are ineligible for the Tier I exemption. The prohibition in Rule 14e-5 does not apply to any purchases or arrangements to purchase securities outside of the tender offer made during the time of any "subsequent offering period" if the consideration paid or to be paid for the purchases or arrangements is made in the same form and amount as the consideration offered in the tender offer.

4. Exemption from Registration under the 1933 Act for Exchange Offers.

(a) The SEC also adopted Rule 802, which provides that securities issued by a U.S. or foreign bidder to the security holders of a foreign private issuer in a business combination or exchange offer will be exempt from the registration requirement of the 1933 Act, if the following conditions are met:

(i) U.S. security holders must hold 10% or less of the subject securities;

(ii) the terms and conditions of the offer must be at least as favorable for U.S. security holders as those terms and conditions offered to other participating security holders, subject to the exception the bidder need not extend the offer to security holders in those states or jurisdictions that require registration or qualification (provided that the bidder offers the same cash alternative to security holders in any such state or jurisdiction that it has offered to security holders in any other state or jurisdiction);

(iii) the securities will be restricted within the meaning of Rule 144 of the 1933 Act to the extent that the subject securities held by the U.S. security holder prior to the transaction were restricted;

(iv) English language translations of any disclosure document provided to offerees must be provided to U.S. security holders in a similar manner and at the same time such information is provided to non-U.S. security holders;

(v) appropriate legends (to the effect that the offer complies with the disclosure requirements of the foreign issuer's home jurisdiction and the financial statements have been prepared in accordance with foreign accounting standards, among other things) must be included in the offering materials; and

(vi) bidders must submit a notification to the SEC on Form CB and, in the case of a foreign issuer and bidder, file a consent to service of process in the United States on Form F-X.

5. Determination of U.S. Ownership. In determining the percentage of shares held by U.S. security holders, for purposes of both the Tier I/Tier II rules and Rule 802, the rules require a bidder to "look through" the record ownership of certain brokers, dealers, banks and nominees holding securities (including ADRs) for the accounts of customers. Accordingly, securities held by nominees for U.S. residents are counted in the calculation of shareholdings of U.S. holders. However, in calculating this amount, the rules provide that the bidder's inquiry may be limited to brokers, dealers, banks and other nominees located in the United States and that of each participant in a business combination or, if different from the home jurisdiction, the primary trading market for the subject company's securities. If, after reasonable inquiry, the bidder is unable to obtain information about the amount of shares represented by accounts of customers resident in the United States, it may assume that the customers are residents of the jurisdiction in which the nominee has its principal place of business. See Rule 800(h) under the 1933 Act, Instruction 2 to paragraphs (c) and (d) to Rule 14d-1 under the 1934 Act, and Instruction 2 to paragraphs (h)(8) and (i) to Rule 13e-4 under the 1934 Act.

(a) In calculating U.S. ownership, the new rules provide that:

(i) The record date for calculating the percentage of outstanding securities held by U.S. holders is to be thirty (30) days before the commencement of the offer or the commencement of the solicitation in a business combination.

(ii) Securities held by persons who hold more than 10% of the subject securities, and shares of the subject class held by the bidder, are to be excluded from both elements of the calculation (i.e., from both the numerator and the denominator).

(b) In addition, Rule 802 provides that, in respect of unsolicited or "hostile" exchange offers conducted by persons other than the issuer of the subject securities or its affiliates, U.S. holders will be presumed to hold 10% or less of the outstanding securities, unless, inter alia: (i) the exchange offer is made pursuant to an agreement with the issuer of the subject securities (which agreement need not be in writing); or (ii) the most recent annual report or annual information filed or submitted by the issuer with securities regulators of the home jurisdiction or with the SEC indicates that U.S. holders hold more than 10% of the outstanding subject class of securities; or (iii) the offeror knows, or has reason to know, that U.S. ownership exceeds 10% of the subject securities. This presumption is not available in negotiated transactions since, in such cases, the bidder would be able to obtain U.S. ownership information from the target company.

6. Reliance on Exemptions in Competing Offers. In order to create a "level playing field" in the event of competing offers, the new rules provide that if a second bidder commences a tender offer or exchange offer, or proposes a business combination, during an ongoing tender or exchange offer or negotiations

pertaining to a proposed business combination for the same securities, the second bidder will be eligible to use the same exemption (either the Tier I or Tier II exemptions or the Rule 802 exemption) as the first bidder, provided that all of the conditions to the exemption, other than the limitations on U.S. ownership, are satisfied by the second bidder.

7. Internet Disclosure. The SEC also provided guidance consistent with its 1998 Internet release regarding the disclosure over the internet of information about offshore tender and exchange offers and rights offerings without triggering the U.S. tender offer and securities registration requirements. In this regard, the SEC cautioned companies that use a web site to publicize offshore tender or exchange offers or rights offering to take "special care" that the site is not used as a means to induce indirect participation by U.S. holders of the subject securities. In the case of business combinations (i.e., mergers and other voting transactions, but not tender or exchange offers) where participation by U.S. shareholders is *not* voluntary, however, no such special precautions need be taken to prevent U.S. shareholders from receiving the merger consideration merely because the proxy statement/prospectus was posted on the web site available in the United States.

X. PROXY SOLICITATIONS.

A. Federal Law.

1. Section 14(a). Section 14(a) of the 1934 Act makes it unlawful to solicit any proxy, consent or authorization in respect of any security registered under Section 12 of the 1934 Act in contravention of the rules and regulations prescribed by the SEC. All issuers whose securities are listed on a national securities exchange or having over $10 million in assets and 500 or more holders of any class of equity securities are required to register that class of securities under Section 12 of the 1934 Act. Issuers that have sold securities and are subject to the informational requirements of Section 15(d) of the 1934 Act, but do not otherwise register a class of securities under Section 12, are not subject to the proxy rules. Pursuant to Rule 3a12-3 under the 1934 Act, securities registered by a foreign private issuer are exempt from Section 14(a) of the 1934 Act.

2. Solicitation of Proxies. Regulation 14A sets forth the rules relating to proxy solicitations. Schedule 14A contains the specific disclosure requirements for proxy statements.

   (a) Proxy Statement. No solicitation subject to the proxy rules may be made unless the person solicited is concurrently or has previously been furnished with a proxy statement containing the prescribed information.

   (b) Annual Report. An annual report to security holders must accompany or precede the proxy statement when soliciting proxies for the annual meeting or a special meeting to elect directors. The proxy rules detail the form and substance of the annual report, which, in most cases, in light of the overlapping disclosure requirements, is prepared by companies in conjunction with the preparation of its Annual Report on Form 10-K, which is required to be filed under the 1934 Act.

   (c) Filing Requirements.

      (i) Preliminary: In certain situations, a preliminary proxy statement and related form of preliminary proxy must be submitted to the SEC for prior review at least ten (10) calendar days before mailing the definitive proxy materials. Preliminary filings are not required if the solicitation relates to any meeting at which the only matters to be acted upon are (A) the election of directors, (B) the selection of accountants, (C) a shareholder proposal or (D) ratification or approval of a new employee benefit plan or amendments to an existing employee benefit plan.

      (ii) Definitive: The definitive proxy materials must be filed with the SEC and any applicable national securities exchange in the same form sent or given to the security holders no later than the date they are first sent or given to security holders.

(d) Beneficial Owners.

Under the Federal proxy rules, registrants must ask brokers, dealers, voting trustees, clearing agencies, banks or other entities that exercise fiduciary powers and hold securities of record in nominee name or otherwise (usually referred to as record holders) whether there are beneficial owners of the securities. The registrant can satisfy its obligation to provide beneficial owners with the required proxy materials in either of two ways:

(i) providing the record holder with the number of copies of the information needed for forwarding to the beneficial owners, or

(ii) obtaining the names of beneficial owners who have not objected to the disclosure of their names, addresses and securities positions and directly mailing the information to such beneficial owners.

(e) Solicitations. Under the Federal proxy rules, the concept of a "solicitation," similar to the concept of an "offer" under the 1933 Act, is broad and includes any request for a proxy, any request to execute, not to execute or to revoke a proxy, and the furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy. The term "proxy" includes every proxy, consent or other authorization within the meaning of Section 14(a) of the 1934 Act. The term solicitation does not, however, apply to:

(i) furnishing a form of proxy to a security holder upon the unsolicited request of such holder,

(ii) providing a list of security holders to a requesting security holder or the mailing of that security holder's materials by the registrant making a proxy solicitation,

(iii) performing ministerial acts on behalf of a person soliciting a proxy, or

(iv) a communication by a security holder who does not otherwise engage in a proxy solicitation stating how that holder intends to vote and the reasons, provided that the communication (A) is by means of speeches in public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media, or newspaper, magazine or other bona fide publication disseminated on a regular basis, (B) is directed to persons to whom the security holder owes a fiduciary duty in connection with the voting of securities held by the security holder, or (C) is made in response to unsolicited requests for additional information with respect to prior communication by the security holder which meet the conditions of this clause.

(f) Exempt Solicitations. The Federal proxy rules exempt certain solicitations from the requirement to provide a proxy statement or other solicitation material, including:

(i) solicitations by a person who does not seek the power to act as proxy for a security holder provided that that person does not have a special interest in the registrant or the initiative presented for a vote,

(ii) solicitations made other than on behalf of the registrant where the total number of persons solicited is not more than ten, or

(iii) the furnishing of proxy voting advice by an advisor who has a business relationship with the recipient of the advice, renders financial advice in the ordinary course of his business, discloses any potential conflicts of interest, receives no special remuneration for furnishing this advice other than from the recipient of the advice and others who receive similar advice, and does not furnish this advice on behalf of any persons soliciting proxies or a participant in any election subject to the contested election proxy provisions.

Solicitations involved in an offer and sale of securities registered under the 1933 Act to be issued in a reclassification, merger, consolidation or transfer of assets specified in paragraph (a) of Rule

145 of the 1933 Act are explicitly not exempt from the proxy rules. In these situations, the securities to be issued are usually registered under the 1933 Act using Form S-4 and the proxy statement becomes the basis for the prospectus and some additional information is added. In effect, the registration statement is "wrapped around" the proxy statement. In connection with merger or other business combination transactions, the disclosure rules will usually require historical and pro forma financial information related to the parties involved in the transactions. In some cases, however, Form S-4 will permit incorporation by reference of reports filed under the 1934 Act to the same extent as permitted in connection with primary offerings using Form S-2 or S-3 and, therefore, will reduce the complexity and length of the Form S-4.

(g) Information Statement. If a registrant does not solicit proxies in connection with an annual or other meeting of shareholders, the registrant is required under Section 14(c) of the 1934 Act, and Regulation 14C thereunder, to file with the SEC and to distribute to shareholders equivalent information to that which would be required if a proxy solicitation were made in the form of an information statement. Information statements have limited utility for listed companies, however, because the NYSE, the AMEX and the Nasdaq require listed companies to solicit proxies for each shareholders meeting.

(h) False and Misleading Statements. No solicitation, including most exempt solicitations, subject to Regulation 14A or Regulation 14C shall be made by any written or oral communication containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct an earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(i) Solicitations Prior to Furnishing a Proxy Statement. Notwithstanding the requirement to provide a proxy statement concurrently with or prior to a solicitation, pursuant to Rule 14a-12 under the 1934 Act, a solicitation may be made prior to furnishing security holders with the required proxy statement if:

(i) all written communications include the identity of the participants in the solicitation and a description of their interests, direct or indirect, by security holdings or otherwise, or a prominent legend in clear, plain language advising security holders where they can obtain the information,

(ii) all written communications include a prominent legend in clear, plain language advising security holders to read the proxy statement when it is available and indicating where they can get the proxy statement and other information for free, including on the SEC's website,

(iii) a definitive proxy statement meeting the requirements of Regulation 14A is sent to security holders before or simultaneously as the proxy form, consent or authorization is furnished to or requested from security holders, and

(iv) any solicitation material published, sent or given to security holders in accordance with Rule 14a-12 must be filed with the SEC and any applicable national securities exchange no later than the date the material is first published, sent or given to security holders (solicitation material in connection with a registered offering under the 1933 Act is required only to be filed under Rules 424 or 425 under the 1933 Act and will be deemed filed under Rule 14a-12).

In addition to the preceding requirements, a solicitation by persons opposing a solicitation by other persons with respect to the election or removal of directors may be made prior to furnishing security holders the required proxy statement provided that, notwithstanding certain other provisions of the Federal proxy rules, any portion of an annual report referred to in the Federal proxy rules that comments upon or refers to any solicitation opposing a solicitation with respect to the election or removal of directors, or to any participant in any such solicitation, other than the solicitation by management, shall be filed with the SEC as proxy material subject to Regulation 14A.

Notably, the use of Rule 14a-12 under the 1934 Act is not limited to business combination transactions and may be used to permit communications by management with shareholders as well as by shareholders among themselves. In addition, although Rule 14a-12 permits both written and oral communications, only written communications, defined broadly to include all information disseminated otherwise than orally, are required to be filed with the SEC.

(j) Shareholder Proposals. Under the Federal proxy rules, shareholders may submit one proposal and supporting statements (together not to exceed 500 words) to management for inclusion in the registrant's proxy statement if they have continuously held at least 1% or $2,000 in market value of securities entitled to be voted on for at least one year prior to the meeting date. Generally, shareholders must submit the proposal to the registrant at least 120 calendar days before the date proxy materials would be mailed based on the prior year proxy mailing, which deadline is communicated to shareholders in the prior year's annual meeting proxy statement. Management may omit a shareholder proposal on procedural grounds, provided that the shareholder has been given an adequate opportunity to correct the deficiency, or on substantive grounds for thirteen (13) different reasons set forth in the proxy rules. If management intends to exclude a proposal, it must notify the SEC in writing no later than eighty (80) calendar days before it files its definitive proxy materials. If management elects to include the proposal in the proxy statement, it may include a statement in the proxy materials opposing the proposal. This statement must be provided to the proponent no later than thirty (30) calendar days before filing the definitive proxy materials.

B. State Law. The disclosure obligations imposed by Federal law in connection with proxy solicitation are in addition to the corporate governance obligations imposed by state law, such as the fiduciary obligations of directors and officers, procedural requirements relating to shareholder meetings, and substantive provisions that may make a shareholder's proposal illegal under applicable state law. Relevant state law provisions include matters relating to meetings of shareholders, fixing the record date, providing notice of a meeting, quorum requirements, voting rights and proxies, written consents in lieu of meetings, inspectors to supervise shareholder meetings of most public companies, and judicial review of elections.

C. Proxies and Voting.

1. Proxy Requirements. In addition to any state law requirements, the Federal proxy rules require that a form of proxy:

(a) indicate in bold whether or not the proxy is solicited on behalf of management or some other party,

(b) provide a specifically designated blank space for dating the proxy card,

(c) identify clearly and impartially each separate matter intended to be acted upon, whether or not related to or conditioned on the approval of other matters, and whether proposed by the registrant or shareholders,

(d) afford an opportunity to specify by boxes a choice between approval or disapproval of, or abstention with respect to, each separate matter referred to therein as intended to be acted upon, other than elections to office, and

(e) set forth the names of the nominees for election as a director, if applicable, and provide an ability to withhold authority to vote for each nominee (a form of proxy may also provide a means for the shareholder to grant authority to vote for the nominees as a group provided that there is a similar means for the shareholder to withhold authority to vote for the group of nominees).

No proxy may confer authority to vote for the election of any person to any office for which a bona fide nominee is not named in the proxy statement, to vote at any annual meeting other than the next annual meeting or to vote with respect to more than one meeting.

2. Registrant Discretionary Voting. A proxy may confer discretionary authority to vote on a matter, at an annual meeting of shareholders, if the registrant did not have notice of the matter at least forty-five (45) days before the date on which the registrant first mailed its proxy materials for the prior year's annual meeting of shareholders (or other date, which may be earlier or later, specified by an overriding advance notice provision set forth in the registrant's bylaws or applicable state law), and a specific statement to that effect is made in the proxy statement or form of proxy. Accordingly, an advance notice bylaw or other state law provision could override the forty-five (45) day period, resulting in a longer or shorter notice period for these purposes. In the event the registrant has received timely notice of the matter, if the registrant includes in the proxy statement information on the nature of the matter and how the registrant intends to exercise its discretion to vote on the matter, proxies will be able to exercise discretionary authority. In this case, the shareholder proposal need not be included on the proxy card but the proxy card must include a cross-reference to the discussion in the proxy statement and a box allowing shareholders to withhold discretionary authority from management to vote on the matter.

   However, even if the registrant includes this information in its proxy statement, the Federal proxy rules prohibit discretionary voting authority on a particular proposal if the proponent provides the registrant with a written statement that the proponent intends to deliver proxy materials to holders of at least the percentage of the registrant's voting shares required under applicable law to carry the proposal and provides the registrant with a statement from any solicitor or other knowledgeable person that necessary steps have been taken to deliver those materials.

3. Quorums and Tabulation of Votes. As to each matter submitted to a vote of security holders, the proxy rules require that the proxy statement disclose any applicable cumulative voting rights and the method by which votes will be counted, including the treatment and effect of abstentions and broker non-votes under applicable state law, corporate governance documents and other applicable rules. The determination of a "quorum" also depends on the treatment of abstentions and broker non-votes:

   (a) Abstentions. Under some state laws and under NYSE rules, abstentions are treated as being present for determining the existence of a quorum and as a "vote cast" against for purposes of determining the approval of a proposal. Under other state laws, the opposite is true. Depending on the relevant state law and other applicable rules, abstentions may be counted in the denominator for determining requisite majorities for corporate actions, thus increasing the affirmative votes needed, but reducing the amount of negative votes as a percentage of shares so counted.

   (b) Broker Non-Votes. Under some state laws and under NYSE rules, shares representing broker non-votes generally are not considered as entitled to vote or voting for purposes of determining the outcome of a particular matter. Therefore, in these circumstances, the practical effect of a broker non-vote (as compared to an abstention in some cases and assuming the presence of a quorum) is to reduce the absolute number of votes required for shareholders to approve a matter. Thus, in some instances, abstentions increase the absolute number of affirmative votes required for approval while broker non-votes generally do not.

4. Broker Discretionary Voting. The NYSE, the AMEX and the Nasdaq permit their broker members, in the absence of instructions from beneficial owners, to vote shares on behalf of the beneficial owner on routine meeting agenda items, such as uncontested elections of directors and the ratification of accountants. However, these brokers may not vote a proxy without beneficial owner instructions on matters that may affect substantially the rights and privileges of the stock, such as business combination transactions and certain issuances of stock, depending on amount and recipient.

D. Stock Exchange Rules. Registrants must also consider the NYSE, AMEX and Nasdaq rules that are applicable to proxies and meetings of shareholders. For example, an important requirement of the NYSE is that "immediate" publicity adequately describing the matter to be considered should be given to the calling of a meeting of stockholders where any matter affecting the rights or privileges of stockholders or any other non-routine matter is to be considered. The NYSE should be given prompt notice (not later than the tenth day prior to the record date) by telephone and in writing of the calling of any meeting of stockholders.

E. Electronic Proxy Solicitation and Voting.

1. Electronic Proxy Solicitation. Pursuant to SEC interpretive releases and applicable state law, registrants may distribute proxy materials electronically if it results in delivery to the intended recipients of substantially the same information as those shareholders would have had if the information had been delivered to them in paper form and if it provides the shareholder an opportunity to retain a permanent record of the information. Electronic delivery should comply with three important criteria:

(a) provide a record of the informed, finite consent of shareholders,

(b) provide separate timely and adequate notice of the intended electronic communication (and the action to be taken) or that new information exists, and

(c) the recipient should be able to access the information without undue burden and have the opportunity to retain that information.

2. Internet Proxy Voting. Even if shareholders do not elect to receive proxy documents electronically, shareholders may place proxy votes electronically if permitted by state law. The key consideration for registrants in this area is to provide a way to determine that the shareholders have actually authorized the matters to be voted upon, i.e. by the use of a security code or social security number. In establishing an electronic voting system, registrants should consult with their counsel to confirm the legality of the process and adequacy of the disclosure.

F. Proxy Contests.

1. Evolving Use. Most proxy contests usually arise in the context of a corporate takeover attempt. The election of new directors is often the only practical method of surmounting such takeover defenses as poison pills and state anti-takeover laws.

2. Issues. Where the acquisition of the corporation is not at issue, there should be clear cut issues that stockholders or special interest groups could be expected to support in order to overcome the pro-management bias of many stockholders. Such issues could be mismanagement, lack of dividends, consistently low stock prices or potential corporate action, such as a liquidation or merger or the adoption of strong anti-takeover measures.

3. Slate of Directors. Individuals with independence, demonstrated sound business judgment and familiarity with the corporation should be sought. Those with controversial or embarrassing histories which can be exploited should be avoided.

XI. LEVERAGED BUYOUTS.

A. Definition. The LBO is a form of acquisition in which the purchaser, with a small equity investment in relation to the purchase price, acquires a business principally with borrowed money relying generally on the credit of the acquired business to support the loan. The acquisition debt is generally serviced through cash generated by the operations of the acquired business and/or the sale of some of its assets, and is typically secured by its assets. Management of the acquiror often receives an equity interest. Such an acquisition is often referred to as an "LBO" or, if it is proposed by or involves management, an "MBO."

B. Considerations.

1. Principal Attributes. An LBO candidate should exhibit some or all of the following characteristics:

(a) substantial unencumbered assets to serve as collateral;

(b) steady earnings and cash flow (operating risk should be relatively low to offset increased interest rate risk);

(c) relative freedom from debt;

(d) experienced management willing to continue or to be brought in; and

(e) off-balance sheet values (e.g., restructuring potential, such as cost reduction, over-funded pension plans, break-up/asset sale potential).

2. Financing. Financing must be sufficient to pay purchase price and transaction costs and to fund working capital.

(a) Components. See V.A.2 for a discussion of traditional components of LBO financing.

(b) Traditional sources of LBO financing (and the financing components they are typically part of) include the following:

(i) banks and finance companies (senior debt);

(ii) insurance companies (senior debt or mezzanine);

(iii) seller take-back debt (mezzanine);

(iv) funds (including LBO funds and pension funds, although equity financing by pension funds may subject the target to restrictions imposed under ERISA's fiduciary rules) (long term senior debt, mezzanine or equity);

(v) interim debt or "bridge financing" typically provided by an investment banker with the expectation that it will be repaid within a year from the proceeds of a public offering of subordinated debt; and

(vi) as a result of changes in Federal tax laws which impose burdensome excise taxes in the event of plan termination, the possibility of using surplus assets from overfunded employee benefit plans of the target is no longer practical; however, even if not used directly, such surplus (i) may reduce cash contributions in the future, which would free up cash for debt service and operations, and (ii) under certain circumstances, could be used to fund retiree health obligations.

3. Vulnerability. An LBO is vulnerable during the negotiation period since it is typically subject to financing, takes a long time to complete and may attract a higher cash bid during the negotiation period. In addition, LBO financing is dependent, to a significant extent, on the availability of debt financing and the deduction for Federal income tax purposes of interest paid on indebtedness.

C. Legal Issues. LBOs raise legal issues that must be carefully considered in any transaction:

1. Fraudulent Conveyances. An LBO may be attacked as a fraudulent conveyance under both the United States Bankruptcy Code (the "Bankruptcy Code") and applicable state fraudulent conveyance or transfer laws. If an LBO is found to run afoul of the fraudulent conveyance laws, many participants in the LBO (such as selling stockholders, lenders that have financed the LBO and investment bankers and lawyers who have received fees in the transaction) may be at risk of having their loans and security interests voided or subordinated and their payments and fees recovered by the debtor-in-possession or other trustee.

(a) General Rule: In general, under 11 U.S.C. Section 548(a), any obligation incurred (such as a loan or guaranty) or transfer of property made (such as a payment or a grant of a security interest) within the applicable statute of limitations (one year under the Bankruptcy Code and six years under the New York fraudulent conveyance law) may be avoided if:

(i) there existed an actual intent to hinder, delay or defraud creditors; or

(ii) the obligation was incurred or the transfer was made for less than reasonably equivalent value and any one of the following tests was met:

A. the debtor was insolvent or was rendered insolvent by the obligation or transfer (i.e., debts, including probable liability on contingent liabilities, exceeded the fair value of assets), or

B. the debtor is left with an unreasonably small capital, or

C. the debtor intended to incur, or believed it would incur, debts beyond its ability to pay as such debts matured.

Under the Bankruptcy Code, and under some states' laws, a transferee or obligee who takes for value and in good faith may retain his transfer or enforce his obligation to the extent of any value given to the debtor for such transfer or obligation.

The fraudulent conveyance law in Section 548 of the Bankruptcy Code protects both creditors existing at the time of the transaction and future creditors. Many state fraudulent conveyance and transfer statutes protect only existing creditors for purposes of the insolvency test set forth above, but protect both existing and future creditors for purposes of the "unreasonably small capital" and "ability to pay debts" tests set forth above. This distinction may be significant in certain factual circumstances.

(b) Due Diligence and Other Protective Measures for Participants. In order to provide some comfort that a transaction will not be avoided as a fraudulent conveyance, participants typically take more than one of the following precautions:

(i) Obtain a professional appraisal of individual assets (which may be on a going-concern basis) or business units or both;

(ii) Investigate contingent and off-balance sheet liabilities (e.g., guaranties, environmental, litigation, product liability and pension);

(iii) Prepare cash flow projections and have these reviewed by an independent public accounting firm (projections and assumptions should be reasonable, i.e., should be based on historical financial statements; should not depend on overly speculative synergies, cost reductions, sales increases or asset sales; and should include sensitivity analysis reflecting best, worst and probable case scenarios with respect to interest rates, growth and other critical factors);

(iv) Prepare a fair value closing date balance sheet reflecting assets at fair value and all liabilities (including contingencies at probable liability). Alternatively, at a minimum, prepare a pro forma balance sheet as of the most recent practicable date prepared as though the transaction had occurred as of such date;

(v) Obtain a solvency letter from a reputable investment bank or appraisal firm;

(vi) Give notice to creditors of the transaction; and

(vii) Avoid, if practical, corporate structures that will tend to invite fraudulent conveyance attacks (e.g., multi-obligor structures with cross and up-stream guaranties and cross-collateralization).

Although not free from doubt under some circumstances, an asset purchase, if practical, is generally preferable to a merger or stock purchase.

None of the above precautions, of course, will guarantee that a transaction will survive a fraudulent conveyance attack. They may, however, provide useful evidentiary support on various issues. With respect to the good faith issue, it is important to note that the good faith of the participants will not alone defeat a finding that there has been a fraudulent conveyance – it may, however, mitigate the extent to which a transfer or obligation is avoided or subordinated.

2. Bulk Sales Laws. Under state bulk sales laws (codified under Article 6 of the UCC and also under some states' tax laws), bulk transfers out of the ordinary course of business of a major part (greater than 50% under case law in certain states) of the inventory or certain other assets of certain enterprises may be avoided if the buyer and seller do not comply with the notice and other requirements of the statute. Buyers and sellers of assets often do not comply with bulk sales requirements because of the administrative burdens of scheduling and notifying creditors and the perceived potential for disruption of the business. Relying on an indemnity by one party for certain liabilities, however, may leave the other party at risk in the event that the indemnitor becomes unable to pay such liabilities.

3. Equitable Subordination. Under equitable subordination principles, a court may subordinate claims of a creditor to those of other creditors of a debtor if (a) the creditor has a fiduciary duty to the other creditors (which may arise out of control of the debtor through equity ownership or through the control of management decisions of the debtor) and takes inequitable actions to the detriment of other creditors, or (b) the creditor acts in bad faith or fraudulently to the detriment of other creditors.

4. Statutory Restrictions on Corporate Distributions. Under state corporate laws, corporations may not make certain distributions in respect of capital stock (such as dividends, redemptions, repurchases or other distributions) if the corporation is or would be rendered insolvent or if the capital of the corporation is or would become impaired. In addition, directors and officers of the corporation who have authorized the distribution may be liable to the corporation to the extent the distribution was illegal.

5. Margin Rules. Regulations U, T, X and G of the Board place limitations on the ability to make loans secured directly or indirectly by margin stock. (See V above.)

6. Bondholder Claims. Bondholders often find their investment downgraded in connection with LBOs due to the substantial increase in the target's indebtedness. Instruments (such as indentures and debenture certificates) governing the target's indebtedness that will remain outstanding must be reviewed carefully to make sure that the transaction or any part thereof will not violate covenants (such as covenants restricting payments to stockholders, prohibiting liens or security interests (or requiring equal and ratable security arrangements), requiring minimum net worth or relating to mergers or similar transactions). Institutional investors now routinely insist on protection from covenants for LBOs and related events, including a requirement to repurchase the bonds upon a change of control or a sale of assets in excess of certain limits.

7. Management Buyouts. LBOs involving management of the target raise unique issues as a result of the inherent conflicts arising out of management's dual roles as participants on the buyer side and as directors and officers of the target. As a result of these conflicts of interest, it is advisable to create an independent committee of the Board of Directors to negotiate on behalf of the stockholders who are not part of the buyout group (which committee should be advised by its own independent counsel and financial advisor), to receive a fairness opinion from such financial advisor as to the fairness of the transaction from the point of view of such non-participating stockholders and, if practical, to obtain the approval of a majority of such non-participating stockholders. (See XIII below.) In addition, the above conflicts give rise to more extensive disclosure obligations under both state and Federal law and greater scrutiny of various contractual provisions such as no-shop provisions, lock-up asset options and stock options and bust-up fees.

8. Tax Considerations. LBOs present many special tax considerations, in addition to those discussed in Article III of this Outline, which arise from the high degree of leverage and the types of financing instruments typically used to fund the transaction.

XII. ACQUIRING OR SELLING BUSINESSES OR ASSETS OF FINANCIALLY TROUBLED COMPANIES.

Outlined below are the opportunities, risks and procedures for acquiring businesses or assets of a financially troubled company, both in and out of bankruptcy.

A. Acquiring or Selling Businesses or Assets of a Financially Troubled Company That is Not in Bankruptcy.

1. Advantages. The acquisition of businesses or assets of a company not yet in bankruptcy may present a unique opportunity for both buyer and seller. The buyer may benefit from an enhanced bargaining position, especially if the seller is being forced to sell assets in order to satisfy debt repayment schedules or as part of a restructuring of its credit arrangements. Conversely, by selling businesses or assets, the seller may be saved from filing for bankruptcy. In addition, even if the seller enters bankruptcy proceedings, it may receive cash from the sale to help fund its operations during the bankruptcy (unless, of course, such funds were required by lenders to be applied to debt reduction at the time received from the buyer). In any event, both parties benefit by completing an acquisition prior to bankruptcy in that they may, subject to certain risks set forth below, avoid the scrutiny of the bankruptcy court.

2. Risks. There are certain risks, however, if the seller subsequently enters into bankruptcy proceedings. These risks include the following:

    (a) Fraudulent Conveyance. If the subsequent bankruptcy occurs within the applicable statute of limitations (one year after the acquisition under the Bankruptcy Code and up to six years under some states' laws), the acquisition may be subject to avoidance as a fraudulent conveyance if the court finds that the purchase price was less than reasonably equivalent value and any of the following tests are met: (i) the seller was insolvent or rendered insolvent by the transfer; (ii) the seller was left with unreasonably small capital; or (iii) the seller intended to incur, or believed it would incur, debts beyond its ability to pay as such debts matured. From the buyer's perspective, the better the bargain that it has made, the greater the risk of a subsequent fraudulent conveyance challenge. Normally, however, the courts should give substantial deference to an arm's-length deal negotiated between unrelated parties where neither party exercised undue influence over the other (especially if the seller has made an attempt to solicit competing offers). Even if a court were to find that the acquisition constituted a fraudulent conveyance, under the Bankruptcy Code, and at least some states' laws, a buyer who takes for value and in good faith may retain a lien on the property or retain the transfer to the extent of any value given to the seller. The modern trend in the case law, however, is to treat a fraudulent conveyance claim as a claim for damages measured by the difference between what was paid and the actual value of the business.

    (b) Automatic Stay and Rejection. If the closing of the acquisition has not yet occurred when the bankruptcy petition is filed, proceedings to enforce the acquisition agreement may be subject to the automatic stay, and the acquisition agreement (as an executory contract) may be subject to rejection by the trustee in bankruptcy (leaving the buyer with a pre-petition unsecured claim for damages in the seller's bankruptcy). Alternatively, competing bidders may attempt to argue that changes in the acquisition agreement, if any, after the bankruptcy proceedings began constitute a new post-petition agreement which is subject to higher and better offers (with the result that the buyer may not even have a claim for damages if his "new" agreement is discarded for the competing offer). Even if the acquisition has closed before the bankruptcy, enforcement of post-closing obligations under the acquisition agreement (such as indemnities) will also be subject to the automatic stay and will require the buyer to file and have allowed its unsecured, pre-petition claim in the proceedings, subject to any objections asserted by other parties in interest. Because the Bankruptcy Code generally disallows unsecured indemnity claims where the indemnitor has not paid any damages to a third party and is contesting liability at the time the Chapter 11 case is confirmed, one partial solution to the foregoing risks is for the buyer to receive a security interest in the seller's assets to secure the indemnity and other obligations under the acquisition agreement. If the buyer has rights of set-off against the seller in connection with the acquisition agreement or otherwise, it may be to the buyer's advantage to wait until the bankruptcy has been commenced before exercising its rights because, under certain circumstances, it will be able to convert what would otherwise be an unsecured claim into a secured claim through the operation of the set-off and other rules of the Bankruptcy Code.

(c) Application of State Statutes. In addition to the protections in the Bankruptcy Code itself, state creditor protection statutes (including the bulk sales provisions of the UCC) may be invoked to frustrate the buyer in the seller's bankruptcy. Under Section 544(b) of the Bankruptcy Code, the trustee may avoid a transfer if the transfer is voidable under applicable state law by a creditor holding an unsecured allowable claim in the bankruptcy. Under bulk sales laws, bulk transfers out of the ordinary course of business of a major part of the inventory or certain other assets of some companies may be voided if the buyer and seller do not comply with the notice and other requirements of the statute. Normally, buyers and sellers often dispense with the requirements of the bulk sales laws due to the administrative burdens and perceived potential detriment to the business, relying instead on an indemnity from the seller for failure to comply. As discussed above, however, the indemnity may be of little value if the seller subsequently enters bankruptcy proceedings.

(d) Successor Liability. Creditors that are not paid in full in a seller's bankruptcy may attempt to assert claims against the buyer for product and other liabilities of the seller that relate to the acquired business (even if not assumed by the buyer), based on certain successor liability theories such as the product line theory or the "de facto" merger theory. Under these theories, a successor purchaser may be liable when (i) the purchaser expressly or impliedly agrees to assume the obligations of the transferor, (ii) the purchaser is merely a continuation of the seller, (iii) the transaction is entered into fraudulently to escape liability, or (iv) the transaction amounts to a consolidation or *de facto* merger.

A buyer's liability can be substantially reduced with respect to claims arising prior to confirmation of a plan of reorganization, by an appropriate order of a bankruptcy court if assets are purchased during the proceeding (rather than before). There is a trend in the courts, however, towards not providing additional protection from successor liability to purchasers of assets in bankruptcy. Some courts have found that where potential successor-liability plaintiffs were not notified of the sale of assets, then the provisions of the sale limiting the purchaser's liability were invalid and unenforceable despite court approval of the sale. See, for example, *In re Savage Indus., Inc*., 43 F.3d 714 (1st Cir. 1994). Other courts have refused protection when there was collusion by the purchaser in the bankruptcy filing to avoid successor liability. See *Nelson v. Tiffany Industries, Inc*., 778 F.2d 533 (9th Cir. 1985). Still other courts have concluded that the bankruptcy court does not have jurisdiction over successor liability claims where the debtor no longer exists as a going concern and the dispute is between the purchaser at the bankruptcy sale and a third party. See, for example, *Zerand v. Cox,* 223 F.3d 159,162 (7th Cir. 1994).

Some federal and state statutes place liability upon the owners or operators of a business based on their status rather than upon past conduct. For example, the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") imposes liability on "owners or operators" of a plant or business regardless of whether those persons actually caused the release or threatened release of a hazardous substance. Thus, even after a sale of assets free and clear of liens and encumbrances, the new owner or operator can find itself liable for the past pollution of predecessors if there is still pollution actively migrating through the ground or air.

ERISA imposes joint and several liability on all members of a "controlled group" of companies for the pension plan current contributions or plan underfundings of a single group member. Controlled group status arises upon an entity being or becoming 80% owned or under common ownership with another entity. A sale of stock that would sever the 80% control gives the

PBGC (the federal agency that insures qualified pensions) the right to assert a lien in the stock being transferred to preserve its underfunding claim.

(e) Joint Venture Risk. Entering into a joint venture with a financially troubled company may pose risks for an investor in addition to those outlined above. If the financially troubled partner owns 80% or more of the venture, the venture – as a member of that partner's "controlled group" or "consolidated group" – may be liable for certain Federal pension and tax liabilities of that financially troubled partner. Also, if the joint venture is controlled by the financially troubled partner and relies heavily on such partner for personnel and services (including cash management services), creditors of such partner may attempt in a bankruptcy proceeding of such partner to cause the venture to be "substantively consolidated," with the result that the venture's assets would be available to satisfy claims of such creditors. This risk can be minimized by insuring that the venture is operated as a distinct and separate entity from the financially troubled partner. The larger the interest held by the non-troubled partner, the less risk there should be of a substantive consolidation with the financially troubled partner.

B. Acquiring or Selling Businesses or Assets of a Debtor in Chapter 11.

1. Advantages. The fact that a company has sought protection under Chapter 11 of the Bankruptcy Code should not deter potential purchasers. In fact, there are certain advantages to purchasing a company that is in bankruptcy.

(a) Opportunity to Make Bid. It may be easier to make an unsolicited bid for the business or assets of a company that is in bankruptcy than to make such a bid in the case of one that is not in bankruptcy. A company not in bankruptcy can refuse or at least resist purchase overtures. While a company is in bankruptcy, a potential purchaser can bypass a reluctant board of directors and approach the creditors' committee, the shareholders' committee or any other party in interest. Furthermore, Chapter 11 companies, or at least some of their assets, often are offered for sale during the proceedings to raise cash, to eliminate unprofitable operations, or if reorganization efforts stall. Agreements entered into during bankruptcy, however, must be approved by the bankruptcy court and are subject to higher and better offers.

It also may be possible to receive bidding incentives such as break-up fees, overbid protections, topping fees, rights of first refusal, and prepayment or reimbursement of due diligence expenses. The court must view any bidding arrangements to be in the best interests of the bankruptcy estate. Control incentives such as lock-ups, and "window shop" and "no shop" clauses are not well received by bankruptcy courts and are not generally approved because of the fiduciary duties of the debtor-in-possession or trustee to obtain the highest and best offer for the estate. One exception may be in circumstances where the debtor has repeatedly tried and failed to find a buyer for its assets and has finally found a buyer willing to make an offer only if a control clause is included.

(b) Mitigation of Claims. Sections 502 and 503 of the Bankruptcy Code provide for the allowance of certain claims against the debtor. In some circumstances, filing for bankruptcy enables a troubled company to reduce certain of the claims against it. For example, a landlord's potential recovery for damages and an employee's recovery for damages arising under an employment contract are both limited by operation of the Bankruptcy Code. Thus, a troubled company in bankruptcy may be able to reduce some outstanding obligations which previously limited the company's economic viability.

(c) Attractive Prices. A Chapter 11 debtor may be anxious to dispose of certain assets quickly because, for example, it may have insufficient capital to operate those assets or it may need their proceeds to fund a plan. A buyer may be able to buy those assets at attractive prices because other potential bidders may be deterred by either the stigma of bankruptcy or the procedural hurdles of Chapter 11, whether real or perceived.

(d) Finality. The acquisition of assets through Chapter 11 proceedings serves to bind all parties in interest. Furthermore, under Section 363(m) of the Bankruptcy Code, the reversal or modification of an order authorizing a sale pursuant to Section 363 does not affect the validity of a sale to a good faith purchaser in a fair auction, whether or not such purchaser knew of the pendency of the appeal, unless the consummation of the sale was stayed.

(e) Free and Clear of Liens. Property sold pursuant to a Section 363 order or pursuant to a confirmed plan of reorganization may, with certain exceptions discussed below, be sold free and clear of all claims and interests of creditors and equity holders. Although environmental cleanup obligations relating to a property purchased in bankruptcy will normally follow the property into the buyer's hands (albeit with the possibility of an indemnity from the seller), the bankruptcy proceeding may provide a unique forum for quantifying and allocating such obligations through negotiations among the buyer, the seller and the environmental authorities. By providing for the discharge of underlying liabilities in a confirmed plan and by assuming only specified liabilities in the acquisition agreement, successor liability for certain liabilities relating to the business or assets purchased (such as product liabilities) that arose before confirmation of the plan may be avoidable.

(f) Tax Exemptions. Acquisitions under Chapter 11 are often afforded tax advantages. For example, under the Bankruptcy Code Section 1146(c) exemption, no transfer or stamp tax that is payable upon delivery of an instrument of transfer (such as a real estate transfer tax or stamp duty on stock transfers) may be imposed if the transfer is pursuant to a confirmed reorganization plan. Furthermore, with certain exceptions, there is no tax on the transfer of property to a successor in interest of the debtor or to an affiliate of the debtor that is a participant in a joint plan with the debtor if the transfer is pursuant to a plan of reorganization.

(g) Registration Exemptions. Subject to certain restrictions, issuances under a plan of reorganization of securities (including any warrant, option, right or conversion privilege distributed as part of a plan and any security issued upon exercise thereof) of the debtor, or of a successor to the debtor under the plan, in exchange for a claim against, or an interest in, the debtor are exempt from registration under Federal and state securities laws. This exemption is not available for persons deemed "underwriters" under the Bankruptcy Code (an underwriter for this purpose includes, among others, any person who purchases a claim against or an interest in the debtor if such purchase is with a view to distribution of any security to be received in satisfaction of such claim or interest).

2. Methods. There are essentially three methods by which assets of a Chapter 11 company may be bought or sold:

(a) the trustee (that is, the debtor-in-possession or a court-appointed trustee) may sell some assets, with court approval, under Section 363 of the Bankruptcy Code;

(b) the business or assets may be sold to a buyer pursuant to a plan of reorganization that has been confirmed by the bankruptcy court; or

(c) potential investors can acquire effective control of a Chapter 11 company by purchasing claims.

3. Section 363. Under Section 363(b) of the Bankruptcy Code, after appropriate notice and a hearing, a company in bankruptcy may dispose of its businesses and assets, even though that disposition is not in the ordinary course of business, so long as a strong business justification exists. See In re Leone Corporation, 722 F.2d 1063 (2d Cir. 1983), at 1071 (citing factors to be considered). Thus, it may not always be possible to acquire a company simply through the purchase of its assets pursuant to a Section 363 sale.

While consent from parties in interest (including creditors) is not necessary for a sale under Section 363, the bankruptcy court must approve the transaction and any party in interest may raise objections. In determining whether to authorize a sale of assets under Section 363(b), the bankruptcy court, in addition to considering the rights of others who have interests in the property (which interests are usually transferred to the proceeds), must balance Section 363(b) interests in light of a possible Chapter 11 reorganization plan. Accordingly, Section 363(b) is normally used to dispose of assets that are not necessary for a reorganization of the debtor.

It is also important to remember that any proposed disposition under Section 363(b) is subject to higher and better offers. In addition, since the debtor has a duty to maximize benefits to the estate, if the asset to be sold is significant, the debtor will be under a duty to seek higher offers.

4. Chapter 11 Reorganization Plan. A Chapter 11 debtor or its assets may also be acquired through a plan of reorganization. The debtor has the exclusive right to file a plan for 120 days after the order for relief has been entered (that is, the filing of the petition in a voluntary case), subject to extension by the court for cause shown. If the court eventually denies the debtor's request to grant further extensions, creditors or any other party in interest may file a plan of reorganization.

   Proposing a plan of reorganization involves the following steps:

   (a) Preparation of a Plan and Disclosure Statement. The plan must, among other requirements, designate classes of claims and interests, specify the treatment of any such class that is impaired under the plan, provide for the same treatment (unless otherwise agreed) for each claim or interest of a class and provide for the means of implementation of the plan (e.g., sale or retention of assets, issuance of securities, cure or waiver of defaults, etc.). The disclosure statement must be in writing and contain information in sufficient detail that would enable a reasonable investor to make an informed judgment about the plan (this does not require information about any other possible or proposed plan).

   (b) Notice and a Hearing on the Disclosure Statement. The court must approve the disclosure statement after notice and a hearing.

   (c) Solicitation of Acceptances or Rejections. Each party in interest must receive the plan or a summary of the plan and the court-approved written disclosure statement before acceptances or rejections may be solicited.

   (d) Acceptance or Rejection of the Plan of Reorganization by Each Party in Interest. Each holder of a claim or interest may accept or reject a plan. A class of claims or interests is deemed to have accepted a plan if such plan has been accepted by creditors or interest holders that hold at least two-thirds in value of the allowed claims or interests of such class and, in the case of a class of claims, by creditors that hold more than one-half in number of the allowed claims of such class. Any class that is not impaired under the plan is conclusively presumed to have accepted the plan.

   (e) Plan Confirmation. After notice, the court must hold a hearing on confirmation of the plan. Any party in interest may object to confirmation of the plan.

   (f) Requirements of Confirmation. The court may confirm a plan only if a number of requirements are met, including the following:

      (i) the plan and its proponent comply with all applicable provisions of the Bankruptcy Code;

      (ii) the plan has been proposed in good faith and is not in any way forbidden by law;

      (iii) with respect to each class of claims or interests, such class has accepted the plan or such class is not impaired under the plan; and

      (iv) with respect to each impaired class of claims or interests, each holder has accepted the plan or will receive value at least equivalent to what it would receive if the debtor were liquidated under Chapter 7 of the Bankruptcy Code.

(g) Cram-down. Where at least one impaired class has accepted the plan, the plan proponent may invoke the fair and equitable provisions of the Bankruptcy Code, sometimes known as the "cram-down" power to confirm a plan over the objection of a non-consenting class.

C. Acquiring Control of a Chapter 11 Company through Purchasing Claims. Generally, investors may purchase claims of creditors of a financially troubled debtor either as an investment (in contemplation of a turnaround) or to position themselves to take over the debtor. Purchasing or "trading" claims can serve as the basis of a takeover of a Chapter 11 debtor or its assets in a number of ways. The acquiror could buy sufficient claims of a class of debt to give it a blocking vote on the debtor's plan of reorganization, or to enable it to secure a majority of the equity distributed in any plan of reorganization or to use it as "currency" to purchase assets of the debtor. For example, Federated Department Stores used this technique to force Macy's management to the bargaining table despite Macy's management's attempts to avoid allowing Federated to acquire Macy's or to participate in Macy's reorganization.

1. Risks. There are certain risks, however, in trying to gain control of a Chapter 11 company by purchasing claims. The court in In re Allegheny International, 118 B.R. 282 (Bankr. W.D. Penn. 1990) relied on Section 1126(e) of the Bankruptcy Code to disqualify the voting power Japonica Partners had gained by purchasing claims. Section 1126(e) allows the court to "designate" (i.e., disqualify) the ballot of "any entity whose acceptance or rejection of a plan was not in good faith." Normally, a creditor may purchase claims to accept or reject a reorganization plan for economic purposes. However, in Allegheny International, Japonica sought to block confirmation of the debtor's plan by purchasing enough claims to gain a blocking position in the two highest classes of impaired creditors, because Japonica was the proponent of a competing plan. Thus, the court found that Japonica's actions went beyond "merely furthering their own economic interests," and thus were in bad faith. Japonica was eventually able to gain control of the company through a settlement.

   In a limited fact pattern, the court in In re Marvel Entertainment Group, Inc., 140 F.3d 463 (3d Cir. 1998), relied on section 1104(a) of the Bankruptcy Code to appoint a neutral trustee to oversee reorganization of a Chapter 11 company. The court found the acrimony between the debtor in possession and the "Icahn Interest" creditors rose to the level of cause necessitating the appointment of a trustee thereby supplanting the voting power the Icahn Interest had gained by purchasing claims.

2. Claims Retain Their Original Vulnerabilities. Except for certain defenses that would not be available to the trustee in the case of a negotiable instrument, purchased claims are subject to preference, fraudulent conveyance, subordination and non-bankruptcy defenses. In addition, a traded claim loses a pre-existing right of set-off since there are no longer mutual claims. Moreover, the creditor acquiring that claim cannot under the Bankruptcy Code use it to offset a payable owed by that creditor to the debtor. Also, a claim purchased at a discount is enforceable by the buyer at the original face amount, except that the portion of the claim representing unamortized original issue discount on the date of bankruptcy must be disallowed as unmatured interest.

3. Trading By Committee Members. Concerns over breaches of confidentiality have led to self-regulation, so that members of the creditors' committee (as well as any insiders of the debtor or other persons with material non-public information) often voluntarily refrain from trading claims. When a committee member desires to sell its claim, typically it will first resign from the committee and disclose to the buyer, after the buyer has signed a confidentiality agreement, non-public information supplied by the debtor. However, in a recent case, the court approved, with the endorsement of the SEC, guidelines for the establishment of a "Chinese wall" to permit committee members who are in the business of making a market in the debtor's securities to continue to trade those securities, notwithstanding their committee memberships. The usefulness of those guidelines to a particular creditor should be determined on a case-by-case basis.

4. Bankruptcy Rule 3001(e). Bankruptcy Rule 3001(e) limits the court's role to the adjudication of disputes regarding transfers of claims. The present rule ought to encourage a free market in trading claims by removing the transfer from judicial scrutiny when no objections are raised by the transferor.

D. Tax Considerations.

1. Net Operating Losses and Other Tax Attributes. Acquisition of control of a financially troubled debtor (whether or not in Chapter 11) through the purchase of its claims or stock typically results in severe limitations on the debtor or successor's use of its NOLs and other tax attributes.

2. Advantages/Disadvantages of Asset Purchases. A significant advantage of purchasing assets from (as opposed to the stock of) a financially troubled debtor in Chapter 11 is avoidance of transferee tax liability. On the other hand, a purchaser of assets may suffer adverse income tax consequences by making a bargain purchase from a debtor. Specifically, if the purchase price allocated to current assets, such as inventory and accounts receivable, is significantly below their fair market value, resale (or collection) of those assets may produce taxable income. Further, an asset sale may result in state and local transfer taxes unless mitigated under the Bankruptcy Code §1146 exemption.

XIII. STATE CORPORATE LAW CONSIDERATIONS.

A. Director Fiduciary Duties. Directors of a corporation have fiduciary obligations to shareholders imposed on them by the law of the corporation's state of incorporation. When the corporation becomes the target of an attempted merger or acquisition, state law requires the board of directors to make an informed decision about the extent to which a proposed acquisition is in the "best interest" of the target's stockholders. The Delaware General Corporation Law is the most influential statute in this area due to the large number of corporations subject to Delaware law and the significant body of leading judicial decisions interpreting Delaware law. When faced with an unsolicited offer, a board of directors must decide whether or not to consider the offer.

The board may "just say no" to an unwelcome suitor if the acquisition would disturb a pre-existing, deliberately conceived, long-term corporate strategy, or if the corporation is simply not for sale. See Paramount Communications, 571 A.2d at 1150-51, 1154. A corporation is "up for sale" when, for example, it initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company. Id.

However, when the corporation, by contrast, is up for sale, just as at other times, the board of directors has the same fiduciary obligation to its stockholders to act fairly, diligently, in good faith and on adequate information, in accordance with directors' fundamental duties of care and loyalty. Barkan, 567 A.2d at 1286. However, in such situations, particularly when break-up of the company becomes inevitable, a board has additional heightened duties, which may require that the directors act as "auctioneers charged with getting the best price for the stockholders at a sale of the company." Revlon, 506 A.2d at 182. See also Hilton Hotels Corp. v. IIT Corp., 978 F. Supp 1342, 1347 (D. Nev. 1997) (applying Nevada law) (holding that the principles articulated in Revlon applied); NBT Bancorp, Inc. v. Fleet/Norstar Financial Group, Inc., 664 N.E.2d 492, 497 (N.Y. 1996) ("corporate directors have a fiduciary obligation to present higher offers to their shareholders"). The duty of the board has thus changed from the preservation of the company as a corporate entity to the maximization of the company's value at a sale for the shareholders. Therefore, in the event of competing bids, the board should conduct the auction process in a way that promotes the bidding for the target, rather than forecloses the ability of one or more bidders to participate. These enhanced duties to seek the best possible bid arise when the corporation (1) initiates an active bidding process, (2) abandons a long-term strategy in response to a bidder's offer, or (3) approves a transaction that results in a sale or change of corporate control. Paramount Communications, 637 A.2d at 42-43. If, however, a board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, the heightened Revlon duties are not implicated.

When a single holder acquires a majority of the voting shares, a change of control is deemed to have occurred. However, when control of a company remains in a "large, fluid, changeable and changing market," board actions will not be subject to enhanced judicial scrutiny. Id. at 47. For example, a merger between two publicly traded corporations, neither of which has a controlling shareholder, will not be deemed a change of control. See Arnold v. Society for Savings Bancorp, Inc., 650 A.2d 1270, 1290 (Del. 1994).

The board of directors may, under certain circumstances, grant "lock-up" options, topping fees and other inducements. See Revlon. Such options can entice other bidders to enter a contest for control of the corporation, thus creating an auction for the company and maximizing shareholder profit. However, lock-up provisions are required to meet a standard of "reasonableness." Lock-up provisions that unduly inhibit a corporation's ability to negotiate with potential bidders are invalid under Delaware law. QVC Network, 637 A.2d at 45, 49, 51. Moreover, in the event directors are "interested" in a particular bidder, then the "entire fairness" of the transaction must be demonstrated. (See XIII.D below.)

B. Limited Liability Companies/Partnerships. Various states have enacted statutes dealing with the existence and governance of LLCs. See New York Limited Liability Company Law ("NY LLCL"); 6 Delaware Code § 18-101 et seq. Limited liability companies are contractual entities that are governed by members or managers. The general duties of such members or managers can either be set forth by statute or can be solely contractual. For instance, in New York, members' duties are similar to those of corporate directors. Compare NY LLCL § 409 (duties of managers) with New York Business Corporation Law § 717 (duties of directors). By contrast, in Delaware, there are no fixed statutory duties. The relevant statute leaves such decisions up to the LLC's members. 6 Del. C. § 1101(c)(2) ("The member's or manager's or other person's duties and liabilities may be expanded or restricted by provisions in the limited liability company agreement."). In addition, Delaware frees from liability any member who acts in accordance with the relevant agreement regardless of any other duties that may or may not be imposed by the common law. 6 Del. C. § 18-1101(c)(1) ("Any such member or manager or other person acting under the limited liability company agreement shall not be liable to the limited liability company or to any such other member or manager or to any such other person for the member's or manager's or other person's good faith reliance on the provisions of the limited liability company agreement.").

Furthermore, due to the contractual nature of an LLC, in the context of a merger, the rights of a member dissenting from a merger approval decision are more limited than a dissenting shareholder in the corporate context. Such a dissenting member has statutory appraisal rights that are substantially similar to those granted to shareholders of business corporations. See NY LLCL § 1002(f); 6 Del. C. § 18-210. However, the sole other remedy available to the dissenting member is to question whether the LLC complied with the provisions of its operating agreement regarding the merger. See, e.g., NY LLCL §1002(g); 6 Del. C. § 18-1101(c)(1). As long as the approving members comply with their duties as set forth in the relevant LLC's operating agreement, the dissenting member cannot bring any action attacking the merger on any other grounds. Id.

The same is true of statutes governing limited liability partnerships ("LLP"). The provisions of the relevant Delaware statute are, for all intents and purposes, identical to the statute governing LLCs. See 6 Del. C. § 17-1101(d)(1) (protecting partner from liability if partner acts in good faith reliance on the relevant partnership agreement); § 17-1101(d)(2) (allowing partnership agreement to expand or restrict partners' duties and liabilities).

Unlike in the corporate context, therefore, LLCs and LLPs provide more protection for managers or partners who run the relevant entities. As long as any acts taken are in adherence with the relevant agreement that created the entity, no liability will attach. It should be noted however, that although the statutes set forth above appear to create less burdensome duties for managers and partners in control of LLCs and LLPs than for directors in the corporate setting, due to the relatively recent nature of these statutes there is little caselaw interpreting the relevant provisions.

C. Business Judgment Rule. The business judgment rule constrains review by courts of directors' decisions. It creates a presumption that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the best interest of the company." Emerald Partners v. Berlin, 2001 WL 1568740 at * 3 (Del. Supr. November 28, 2001); British Printing & Communication Corp. v. Harcourt Brace Jovanovich, Inc., 664 F. Supp. 1519 (2d Cir. 1987) (applying New York law) ("the Court is barred by the 'business judgment rule' from second-guessing actions taken by the directors 'in good faith and in the exercise of honest judgment in the lawful and legitimate furtherance of corporate purposes'") (citations omitted); Lauffs v. Hagopian, 2001 WL 1480531, at * 2 (Cal. App. 4 Dist. 2001) ("Under this rule, a director is not liable for a mistake in business judgment which is made in good faith and in what he or she believes to be the best interests of the corporation, where no conflict of interest exists."). If these threshold conditions are not rebutted, the directors' judgment will be sustained by the courts when it can be attributed to a rational business purpose and is not the product of an abuse of discretion.

The business judgment rule generally affords a board of directors broad latitude, and is applicable to the actions of corporate directors responding to takeover threats. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955-956 (Del. 1985). However, in such situations, the board of directors must first satisfy the underlying principles of:

1. The duty of loyalty, which (for example) forbids directors from having an interest in both parties to a proposed acquisition;
2. The duty of care, which requires that directors inform themselves as to all available material information and act with requisite care in the discharge of their duties; and
3. The duty of good faith

before they will be entitled to the presumption of legitimacy. Cf. Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 273 (2d. Cir. 1986) (unlike in other jurisdictions, "under New York law the initial burden of proving directors' breach of fiduciary duty rests with the plaintiff.

Since the mid-1980s, courts have exercised greater scrutiny over board decisions to block hostile takeover attempts. This is due to the fear that in such situations a board may act in its own interest rather than those of the corporation and stockholders. The business judgment rule will not protect takeover defenses if they are not reasonably related to the threat posed, or if the board has failed to inform itself adequately about the takeover bid before employing defensive measures. Gilbert v. El Paso Co., 575 A.2d 1131, 1143-45 (Del. 1990); Unocal Corp., 493 A.2d at 955-56. Courts have criticized directors for failing to consider acquisition proposals in sufficient depth and for an adequate period of time, to scrutinize management's determination of the target's value, to undertake a prudent search for alternatives to an acquisition offer, and to substantiate their deliberations with expert advice such as fairness opinions from independent financial advisors. Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993); Hanson Trust, supra; Revlon, supra.

Certain formal procedures will assist a board of directors in gaining the protection of the business judgment rule:

1. in advance of a meeting, distributing written material sufficient to advise the directors fully of the subject matter, including a summary of all operative documents;
2. retaining independent investment bankers, lawyers and other advisors to the extent necessary and probing the basis for their advice; and
3. thoroughly discussing the acquisition offer over the course of several meetings, questioning representatives of management and outside advisors, and understanding the effect of the transaction on the target.

In the context of LLCs and LLPs, a similar rule is applied in that, in addition to looking at the relevant agreement, the courts can also look to the reasonableness of the actions taken. See, e.g., NY LLCL § 409(a) ("A manager shall perform his or her duties as a manager … in good faith and with that degree of care that an ordinarily prudent person in a like position would use under similar circumstances."); Wyler v. Feuer, 85 Cal.App.3d 392 (Cal. Ct. App. 1978) (acknowledging similarity between characteristics of a general partner in an LLP to those existing in corporate investment and holding that "[t]he good faith business judgment and management of a general partner need only satisfy the standard of care demanded of an ordinarily prudent person, and will not be scrutinized by the courts with the cold clarity of hindsight").

D. Fairness Considerations. The business judgment rule will not protect directors who are not independent, or have a material financial or other interest in the transactions differing from that of shareholders generally.

Such directors are considered "interested," and therefore not objective as to the valuation of an acquisition proposal in LBOs and other going private transactions. Interested directors must demonstrate the "entire fairness" of a proposed acquisition, including the presence of fair dealing and a fair price. Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983); Kahn v. Lynch Communications Systems, Inc., 669 A.2d 79, 84 (Del. 1995) (noting that "a controlling or dominating shareholder standing on both sides of a transaction . . . bears the burden of proving its entire burden," and applying the Weinberger fairness standard) (citation omitted). See also Alpert v. 28 William St. Corp., 473 N.E.2d 19, 26-7 (N.Y. 1984) ("when there is an inherent conflict of interest, the burden shifts to the interested directors or shareholders to prove good faith and the entire fairness of the merger"). In such transactions, a committee of independent directors is typically appointed to evaluate acquisition proposals. To ensure its independent negotiating status, the independent committee generally must be assisted by its own legal counsel and financial advisors.

Similarly, if a shareholder successfully rebuts the presumption of the business judgment rule by proving the board of directors breached one of its triad of fiduciary duties: due care, loyalty or good faith, this duty to prove that the challenged transaction was "entirely fair" arises. Emerald Partners, 2001 WL 1568740 at *3.

E. Transfer of Control. Case law in some states treats "control" of a majority interest in a corporation as a corporate asset and imposes fiduciary obligations in favor of minority stockholders.

1. Sale of Control.

(a) The seller of control may be liable for damages if it is on notice that a buyer intends to "loot" the target.

(b) A higher level of disclosure may be required where control is sold at a premium.

(c) Sale of control at a premium is generally subject to close scrutiny by courts in all states.

(d) Generally, problems are minimized if the offer is made for the control block and minority interest at the same price.

2. Acquisition of Control. If an acquirer obtains control of the target, but minority interests remain, then the acquirer as majority stockholder has a fiduciary duty to the minority stockholders, due to potential conflicts of interest arising from the following types of activities:

(a) intercompany transactions (including pricing);

(b) allocation and cost of capital;

(c) intercompany charges (general and administrative expenses, research and development, etc.); and

(d) extraordinary transactions such as a merger, an amendment to the certificate of incorporation or sale of substantially all assets requiring stockholder approval.

F. Elimination of Minority Interests.

1. Advantages:

(a) eliminates conflict of interest problems thereby providing greater intercorporate flexibility; and

(b) if the target is a public company, eliminates reporting and disclosure requirements, separate financial statements, associated compliance costs, etc.

2. Methods:

(a) tender offer (followed by merger);

(b) merger into acquirer or merger or reverse merger involving wholly-owned subsidiary;

(c) sale of assets to the acquirer or to a subsidiary followed by liquidation;

(d) reverse stock split (cash for fractional shares); or

(e) acquisition of stock in open market or privately negotiated purchases.

3. Special Considerations:

(a) Going Private Transactions. Rule 13e-3 of the 1934 Act requires an issuer and its affiliates engaging in a going private transaction, with limited exceptions, to disclose extensive information about the fairness and terms of the transaction. Included in the required information are plans or proposals of the issuer and its affiliates regarding extraordinary or other material corporate transactions and the past contacts, transactions or negotiations with the target company. The information must be included in a Schedule 13e-3 which is generally filed simultaneously with the filing of the required tender offer or proxy materials. Rule 13e-3 applies to any transaction with a reasonable likelihood or the purpose of causing the termination of reporting obligations under the 1934 Act by causing the class of securities involved to be held of record by fewer than 300 persons, or the securities to be neither listed on any exchange nor authorized to be quoted on an interdealer quotation system. Rule 13e-3 is especially pertinent to short form mergers, issuer tender offers and other types of going private transactions that are not otherwise subject to Federal filing and disclosure requirements.

(b) State case law applies varying standards, ranging from an outright prohibition to a fair price test or legitimate purpose test, in connection with transactions eliminating minority interests.

(c) The Delaware Approach. Delaware utilizes an "entire fairness" of the transaction test in scrutinizing cash-out mergers – those in which a majority stockholder seeks to eliminate the interests of minority stockholders. As interpreted in the leading case, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983), entire fairness consists of two elements: fair dealing and fair price. See also Kahn, 669 A.2d 79, 84 ("Fair dealing addresses the timing and structure of negotiations as well as the method of approval of the transaction, while fair price relates to all the factors which affect the value of the stock of the merged company."). "Complete candor" between the parties is required, and arm's-length bargaining is preferred. However, the Weinberger court rejected the requirement that the board meet the "legitimate business purpose" test – which had been adopted in Singer v. Magnavox, 380 A.2d 969 (Del. 1977) – in reviewing cash-out mergers. The Chancery Court has stated that in a tender offer situation the lack of arm's-length negotiations does not "ipso facto indicate an unfair price. It is one factor to be considered." Joseph v. Shell Oil Co., 482 A.2d 335, 343 (Del. Ch. 1984).

Minority stockholders may seek an appraisal pursuant to Section 262 of the DGCL. See also Paskill Corp. v. Alcoma Corp., 747 A.2d 549, 553 (Del. 2000) ("The Delaware appraisal statute affords dissenting minority stockholders the right to a judicial determination of the fair value of their shareholdings."). If, however, an appraisal would not provide adequate relief, or if a party is charged with bad faith that goes beyond issues of mere inadequacy of price, a court may rely on additional remedies in order to provide full relief. See Rabkin v. Philip A. Hunt Chemical Corp., 498 A.2d 1099 (Del. 1985); Turner v. Bernstein, 776 A.2d 530, 546-47 (Del. Ch. 2000) (citing to Rabkin and noting that "if there was any procedural unfairness in connection with a merger, even if the only result was an unfair price, appraisal would not be adequate to remedy the wrong, and therefore, would not be exclusive.") (citation omitted).

XIV. TAKEOVER DEFENSE MEASURES.

A. Structural Defenses. Publicly traded companies may be expected to have or to use structural defenses ("shark repellents") to a takeover. These defenses can include the following:

1. Shareholder rights plans or "poison pills" generally permitting stockholders (other than the offeror), upon the occurrence of specified events, to purchase equity securities of the target ("flip-in") or other surviving entity ("flip-over") for a low price, thereby making the acquisition of the target prohibitively expensive or dilutive for the offeror;

2. Charter and by-law provisions requiring a high or “supermajority” stockholder vote, such as 80%, to approve acquisitions in which a lower price in cash or securities is offered in a second step merger than was offered in the first step tender offer;

3. Authorization to issue substantial additional stock or “blank check” preferred stock, often with disadvantageous consequences to a potential tender offeror;

4. Staggered terms of the members of the board of directors whereby only one-third of the board is elected each year, thus extending the time required and making it more difficult to obtain control of the board of directors;

5. Expensive severance agreements or “golden parachutes” with senior management;

6. Expensive, in the aggregate, severance benefits for all employees (“tin parachutes”);

7. Elimination of the right of stockholders to call meetings and action by stockholders by written consent in lieu of a meeting, and charter prohibitions on the repurchase of the target stock at a premium or “greenmail”;

8. Recapitalization or restructuring the target to redeploy assets or modify business goals or practices; and

9. An ESOP holding a substantial block of the outstanding target stock. (See XIX below.)

B. Common Responses to an Unsolicited Offer. Responses to an unsolicited offer by the target of that offer often include:

1. The commencement of litigation against the offeror, particularly if sufficient stock has been purchased to necessitate a Schedule 13D filing with the SEC, or if there is a possible antitrust or regulatory violation;

2. A relatively quick sale of the company to a “white-knight” or a third party considered more friendly, perhaps combined with a “lock-up” option or a “crown jewel” sale;

3. The sale of a “crown jewel” or substantial assets of the target at favorable prices, or granting of a “lock-up” or an option to purchase a substantial amount of stock at a favorable price to a third party. Both such practices have been severely limited by adverse judicial decisions. See, e.g., Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1286 (Del. 1988); QVC Network, Inc. v. Paramount Communications Inc., 635 A.2d 1245, 1270-73 (Del. Ch. 1993), aff’d., 637 A.2d 34 (Del. 1994); see also XIII.A. supra;

4. The repurchase by the target, through tender offer or otherwise, of a substantial amount of its common stock;

5. The close monitoring of trading by the target of its stock to detect accumulations;

6. The special dividend or “spin off” of the target’s assets;

7. A public relations campaign to discourage an unsolicited offer or disparage an offeror in conjunction with the “just say no” defense; and

8. The acquisition of a regulated business to create barriers to an offeror (such as a broadcast license, a railroad or a public utility).

XV. FEDERAL AND STATE SECURITIES LAW CONSIDERATIONS.

A. Securities Act of 1933.

1. Application. Every offer or sale of a security in interstate commerce or through the mails requires registration with the SEC unless an exemption is available. “Security” is broadly interpreted and includes debt as well as equity instruments, investment contracts and guarantees.

2. Exempt Securities.

(a) Securities issued or guaranteed by United States Federal, state and local governments or other public instrumentalities or political subdivisions thereof, securities issued or guaranteed by banks (including United States branches and agencies of foreign banks) and certain securities issued by insurance companies.

(b) Short term commercial paper:

(i) which arises out of a "current transaction" or the proceeds of which are to be used only to finance "current transactions," but in no event equity investments or permanent real estate financings; and

(ii) which is "prime quality"; many banks will provide companies with commercial paper guarantees through letters of credit to satisfy this requirement.

(c) Interests in arrangements by or for common carriers to finance the acquisition of rolling stock.

(d) Securities exchanged by the issuer with its existing security holders, exclusively where no commission is paid for soliciting the exchange.

3. Exempt Transactions.

(a) Sales by persons other than an issuer, underwriter or dealer.

(b) Sales which do not involve a "public offering" including the "safe harbor" exemption pursuant to Regulation D under the 1933 Act.

(c) Brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market, but not the solicitation of such orders.

(d) Certain real estate mortgage notes.

4. Registration.

(a) Standard Forms. United States issuers (including most United States subsidiaries of foreign corporations) are required to use registration Forms S-1, S-2 or S-3. Forms F-1, F-2 and F-3 are for use by foreign private issuers, defined in Rule 405 under the 1933 Act as any foreign issuer, other than a foreign government, except an issuer having (1) more than 50% of its outstanding voting securities held by residents of the United States, and (2) (i) the majority of its executive officers or directors are citizens or residents of the United States, or (ii) more than 50% of its assets are located in the United States, or (iii) its business is administered principally in the United States. Forms S-1 and F-1, for all first-time issuers, require the most disclosure. Forms S-2 and F-2 require less disclosure on the theory that markets have already absorbed relevant information on issuers. Forms S-3 and F-3 require minimal disclosure, provided certain filing and financial requirements are met. Corresponding "S" and "F" forms are similar, although the disclosure requirements for foreign issuers are generally more flexible.

(b) Specific Forms. Specific forms are available for:

(i) eligible Canadian issuers (Forms F-7, F-8, F-9, F-10 and F-80 which generally allow for delivery of home jurisdiction offering documents);

(ii) for offerings involving mergers and other business combinations (Forms S-4 and F-4 which combine registration with proxy disclosure); and

(iii) for offerings by a small business issuer, defined in Rule 405 as an entity that (v) has revenues of less than $25,000,000, (w) is a United States or Canadian issuer, (x) is not an investment company, (y) if a majority-owned subsidiary, the parent corporation is also a small business issuer, and (z) has a public float (the aggregate market value of the outstanding securities held by non-affiliates) of less than $25,000,000 (Forms SB-1 and SB-2 which have simplified disclosure requirements).

(c) Disclosure. A registration statement on Form S-1 (which includes the prospectus used in offering securities) must include:

(i) financial statements of the issuer (audited balance sheets for the last two fiscal years and audited statements of income and cash flows for the last three fiscal years); financial statements of businesses acquired or to be acquired for various periods depending on the significance of the acquisition as well as pro forma financial information showing the effects of the acquisition; financial statements of foreign private issuers are generally presented in currency of the issuer's country of organization (foreign accounting principles may be used, but material differences with United States accounting principles must be disclosed as well as foreign exchange information);

(ii) management's discussion and analysis of financial condition and results of operations;

(iii) business and property descriptions;

(iv) selected financial data (operating revenues, income or loss, income or loss per common share, total assets, long-term obligations, redeemable preferred stock and cash dividends per common share) for the last five fiscal years;

(v) management remuneration and transactions (disclosure is extensive for United States issuers; foreign issuers are generally required to disclose only total compensation to officers and directors as a group);

(vi) legal proceedings;

(vii) risk factors; and

(viii) use of proceeds.

(d) Rule 421(d) requires that the front portion of a prospectus be written in plain English and the entire prospectus be clear, concise and understandable. Plain English entails substantial compliance with six basic principles:

(i) short sentences;

(ii) definite, concrete, everyday language;

(iii) active voice;

(iv) tabular presentation or bullet lists for complex material, whenever possible;

(v) no legal jargon or highly technical business terms; and

(vi) no multiple negatives.

(e) The SEC will often review the registration statement and generally issue comments to the issuer requiring changes to the registration statement. This process may involve one or more rounds of comments and take several months. Once these comments have been addressed to the SEC's satisfaction, or if the SEC has decided not to review the filing, the issuer may then pursue having the registration statement declared effective.

(f) When the registration statement is declared effective, the offering can be made by means of the prospectus included in the registration statement, which is both a selling and a disclosure document.

(g) Expenses:

(i) filing fee of $80.90 per million dollars of aggregate offering price;

(ii) printing expense; and

(iii) legal and accounting fees.

5. <u>Exemptions from Registration: Regulation D</u>. A series of rules under the 1933 Act establishes "safe harbor" exemptions from the registration requirements of the 1933 Act in connection with the private placement of securities.

(a) Regulation D:

(i) is a non-exclusive means of effecting an offering which is exempt under Section 4(2);

(ii) applies only to the issuer, not to its affiliates or to others for resales;

(iii) applies to business combination transactions;

(iv) does not exempt transaction from anti-fraud provisions; and

(v) does not obviate the need to comply with any applicable state securities laws.

(b) Rule 501 defines the terms used in Regulation D:

(i) "Accredited investors" include banks, registered brokers and dealers, insurance companies, registered investment companies, certain employee benefit plans, private venture capital companies corporations and partnerships with assets in excess of $5,000,000, directors, executive officers or general partners of the issuer, trusts with assets in excess of $5,000,000, individuals with net worth in excess of $1,000,000 or with annual income in each of the two most recent years in excess of $200,000 (or jointly, $300,000), trusts with assets in excess of $500,000 and directed by a "sophisticated person," and any entity in which all equity owners are accredited investors;

(ii) "Business combination" includes mergers and acquisitions of control of the issuer, involving an exchange of securities, and certain transfers of assets; and

(iii) "Purchaser representative" means a person who "has such knowledge and experience in financial and business matters that he is capable of evaluating . . . the merits and risks of the prospective investment" and satisfies certain other conditions.

(c) Rule 502 outlines certain general conditions that are required to be met including:

(i) offers and sales (other than offers and sales under certain employee benefit plans) made more than six months before the start or after the completion of a Regulation D offering and exempt offerings made outside the United States will not, generally, be integrated with the subject Regulation D offering; factors to be considered in determining whether other offers and sales should be integrated are specified;

(ii) information comparable to applicable registration statement disclosure (including financial statement information) must be furnished to investors in connection with Regulation D transactions; abbreviated disclosure is available to foreign private issuers (such information need not be furnished either to accredited investors or in connection with sales of securities not exceeding $1,000,000);

(iii) offers and sales may not be made by any form of general solicitation or advertising (other than in connection with sales of securities not exceeding $1,000,000); and

(iv) securities acquired in a Regulation D transaction are restricted securities and cannot be resold without registration under the 1933 Act or in reliance on an available exemption from registration (see XV.A.6 infra) (other than those acquired in connection with sales of securities not exceeding $1,000,000).

(d) Rule 503 requires the filing of a notice of sale on Form D (the failure of which will not jeopardize the availability of the exemption for the current transaction, but may limit the ability of the issuer to claim the exception for future offerings).

(e) Assuming compliance with the general conditions specified in Rule 502, Rule 504 exempts offers and sales not exceeding $1,000,000 in the aggregate within any 12-month period to an unlimited number of persons by non-reporting companies.

(f) Assuming compliance with the general conditions specified in Rule 502, Rule 505 exempts offers and sales not exceeding $5,000,000 in the aggregate within any 12-month period to not more than 35 purchasers (exclusive of accredited investors).

(g) Assuming compliance with the general conditions specified in Rule 502, Rule 506 exempts offers and sales without dollar limitation to not more than 35 purchasers (exclusive of accredited investors) provided the issuer believes each purchaser (other than an accredited investor) has, either alone or with his purchaser representative, "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment."

(h) Rules 507 and 508 provide, respectively, for certain penalties for failure to comply with Regulation D and a defense of a good faith effort to comply with Regulation D.

6. <u>Exemptions from Registration: Rule 144A</u>. Rule 144A under the 1933 Act allows purchasers (including dealers) of unregistered or restricted securities to resell them to "Qualified Institutional Buyers" ("QIBs") without registering such securities or satisfying the requirements of another exemption including the cumbersome restrictions applicable to Rule 144 resale transactions discussed below.

(a) Rule 144A does not:

(i) Apply, by its terms, to initial sales by an issuer, although it does permit sales by an issuer to a dealer (or to a QIB) for resales to QIBs to be classified as private placements;

(ii) Exempt transaction from anti-fraud provisions; and

(iii) Obviate the need to comply with the 1934 Act or any applicable state securities laws.

(b) QIBs, by definition within Rule 144A, generally include among others:

(i) Institutions that in the aggregate own or invest on a discretionary basis $100,000,000 in securities of issuers that are not affiliated with the entity (excluding bank deposit notes, certificates of deposit, loan participations, securities subject to repurchase agreements and swaps).

(ii) Domestic and foreign banks and savings and loan institutions that in the aggregate own or invest on a discretionary basis $100,000,000 in securities of issuers that are not affiliated with the entity and have an audited net worth of at least $25,000,000.

(iii) Registered broker-dealers that in the aggregate own or invest on a discretionary basis $10,000,000 in securities of issuers that are not affiliated with the entity. A broker-dealer can act as agent in Rule 144A transactions on a non-discretionary basis or as a "riskless principal" (<u>i.e</u>., purchase and concurrently resell to a QIB) without otherwise qualifying as a QIB.

(c) To qualify for the Rule 144A exemption, a QIB must be purchasing for its own account or the accounts of other QIBs and:

(i) The seller must reasonably believe the offeree or purchaser is a QIB based on such information as available financial statements, governmental filings, "recognized securities manuals" or certification from an executive officer of the purchaser.

(ii) The seller must take reasonable steps to ensure the purchaser is aware that the sale is being made in reliance on Rule 144A.

(iii) The securities sold must not be of the same class as securities listed on a United States securities exchange or quoted on Nasdaq. Securities that are convertible or exchangeable into securities so listed or quoted with an effective conversion premium of less than 10% are treated as securities of the class into which they are convertible or exchangeable. Warrants exercisable for securities so listed or quoted with a life of less than three years or an exercise premium of less than 10% will also be treated as securities of the class to be issued on exercise. As a practical matter, this requirement makes Rule 144A unavailable for publicly traded equity securities.

(iv) Holders and prospective purchasers must have the right to obtain from issuers (other than domestic issuers subject to the reporting requirements of the 1934 Act and foreign issuers which file home country reports with the SEC under Rule 12g3-2(b) under the 1934 Act) the following information:

A. a brief statement of the nature of the business of the issuer and the products and services it offers; and

B. the issuer's most recent balance sheet and profit and loss and retained earnings statements for the preceding two years.

7. <u>Exemptions from Registration: Regulation S</u>. Regulation S provides an exemption from registration for transactions that occur outside the United States:

(a) Regulation S sets forth two nonexclusive safe harbors for:

(i) offers and sales of securities by the issuer, a distributor, any of their respective affiliates or persons acting on their behalf; and

(ii) resales of securities by investors.

(b) Two general conditions must be satisfied to rely on the exemption afforded by either safe harbor:

(i) the offer must not be made in the United States and either (A) at the time the buy order is initiated, the buyer must be reasonably believed to be outside the United States or (B) in the case of the issuer, the transaction must be executed on or through the physical trading floor of an established foreign securities exchange or, in the case of a resale, on or through facilities of a "designated offshore securities market" and the trade must not be pre-arranged with a buyer in the United States; and

(ii) directed selling efforts (<u>i.e</u>., activities for the purpose of, or which could reasonably be expected to have the effect of, conditioning the market in the United States for the securities being offered) are prohibited. There are limited exceptions to this prohibition for advertisements required by law or placed in certain foreign publications with limited United States circulation, such as <u>The Financial Times</u>.

(c) The issuer safe harbor distinguishes three types of offerings based upon the nationality and reporting status of the issuer and the degree of United States market interest in the issuer's securities. Additional restrictions are imposed on types of securities commensurate with the SEC's view of the extent of the risk that the securities will flow back into the United States after the initial sale abroad. In particular, the SEC treats equity securities issued offshore by U.S. companies under Regulation S as "restricted securities" under Rule 144 of the 1933 Act, so that resales without registration are restricted.

8. <u>Other Exemptions from Registration under the 1933 Act</u>.

(a) Beyond the Regulation D safe harbor, Section 4(2) of the 1933 Act exempts transactions by an issuer not involving a public offering. This general exemption requires consideration of several factors including:

   (i) the number of offerees (generally limited to twenty-five but can be larger);

   (ii) the size and manner of the offering;

   (iii) the access of offerees to relevant information;

   (iv) the financial sophistication of offerees (such as institutional investors); and

   (v) the risk that offerings will be integrated, resulting in loss of the exemption for all.

(b) Rule 145 under the 1933 Act, which is applicable to mergers and consolidations and asset acquisitions for securities:

   (i) defines certain such transactions as involving an "offer," thereby requiring registration unless an exemption is available;

   (ii) defines the parties in the acquisition transaction, other than the issuer, and the affiliates of such parties to be "underwriters" if they publicly offer or sell securities of the issuer acquired in connection with any such transaction; and

   (iii) provides a resale exemption for such "underwriters"; such persons and parties may resell shares received without registration if (A) the resale is effected in compliance with the public information availability, volume limitations, and manner of sale provisions of Rule 144 discussed below, (B) such persons are not affiliates of the issuer, at least one year has elapsed since the securities were acquired from the issuer and the issuer satisfies the current public information test of Rule 144, or (C) such persons are not, and have not been for at least three months, affiliates of the issuer and at least two years have elapsed since the securities were acquired from the issuer.

(c) Rule 144 under the 1933 Act provides a safe harbor exemption for sales of "restricted" and "affiliate" securities by persons other than the issuer if the following conditions are met:

   (i) current and adequate public information about the issuer is available (this requirement is satisfied if the issuer is a reporting company under the 1934 Act and has filed all reports required to be filed in the previous 12 months);

   (ii) restricted securities in question are subject to a one-year holding period from the date of acquisition of the securities from the issuer or an affiliate of the issuer;

   (iii) sales of restricted securities in question must not exceed, during any three-month period, volume limitations equal to the greater of 1% of outstanding securities and the average weekly trading volume of such securities over a four-week period;

   (iv) restricted securities in question must be sold without solicitation in a "broker's transaction" or to a "market maker" and without payment to any person other than the broker executing the sale;

   (v) Form 144 must be filed if sales made in reliance on Rule 144 in any period of three months exceed 500 shares or other units or will have an aggregate sale price in excess of $10,000;

   (vi) a bona fide intent to sell must be present; and

   (vii) if the restricted securities have been subject to a two-year holding period from the date of acquisition of the securities from the issuer or an affiliate of the issuer and are held by a person that is not, and for the three months preceding the sale has not been, an affiliate of the issuer, the conditions summarized above in (i), (iii), (iv), and (v) do not apply.

B. Securities Exchange Act of 1934.

1. Consequences of Going Public. If total assets exceed $10,000,000 (with certain exceptions) and a class of equity securities is held by 500 or more persons (and, in the case of certain non-United States issuers, 300 or more reside in the United States), such class must be registered under Section 12(g) of the 1934 Act.

   (a) Registration must be made within 120 days of the close of the fiscal year in which the tests are satisfied.

   (b) One-time registration of a class of securities of an issuing corporation as distinct from 1933 Act registrations of particular sales of securities.

   (c) Securities of certain non-United States issuers are generally exempt from registration if information material to an investment decision is furnished to the SEC, including:

      (i) financial condition or results of operations;

      (ii) changes in business;

      (iii) acquisitions or dispositions of assets;

      (iv) issuance, redemption or acquisition of the issuer's own securities;

      (v) changes in management or control;

      (vi) granting of options or payment of other compensation to directors or officers;

      (vii) transactions with directors, officers or principal security holders; and

      (viii) disclosures of material non-public information to persons outside the issuer in accordance with Regulation F-D under the 1933 Act.

2. Ongoing Reporting for United States Issuers. United States issuers that have securities registered under Section 12 or that have registered securities under the 1933 Act must file:

   (a) Annual Reports on Form 10-K;

   (b) Quarterly Reports on Form 10-Q; and

   (c) Current Reports on Form 8-K, upon the occurrence of certain significant events, including:

      (i) changes in control;

      (ii) acquisition or disposition of a significant amount of assets;

      (iii) bankruptcy or receivership;

      (iv) change in certifying accountant;

      (v) other materially important events (at issuer's option);

      (vi) resignation of directors;

      (vii) change in fiscal year; and

      (viii) disclosures of material non-public information to persons outside the issuer in accordance with Regulation F-D under the 1933 Act.

   Proposed Rules under the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") would require additional disclosure on Form 8-K, including changes or waivers to issuer's codes of ethics. The SEC has also requested comment on whether the arrival or departure of a financial expert to or from the issuer's board of directors ought to be required to be disclosed on Form 8-K. There is a separate proposal to expand the list of reportable events on Form 8-K, but it is unclear at this time which events the SEC will include, and which it will not.

3. Ongoing Reporting for Non-United States Issuers.

   (a) Non-United States issuers that have securities registered under Section 12 or that have registered securities under the 1933 Act must file:

      (i) Annual Reports on Form 20-F.

         A. An integrated form used both as a registration statement to register securities of qualified foreign private issuers under Section 12 or as an annual report under Section 13(a) or 15(d); and

         B. Substantially similar financial presentation as required for 1933 Act registration statements (see XV.A.4 above), therefore similar to the 10-K report filed by domestic companies, although not as much information must be disclosed for foreign companies on the Form 20-F.

      (ii) Current Reports on Form 6-K.

   (b) Canadian issuers can comply with periodic reporting requirements by filing either a Form 20-F, the standard form for foreign issuers, or, in certain cases, a Form 40-F accompanied by documentation filed pursuant to Canadian reporting requirements.

   (c) Depositary shares registered on Form F-6, but not the underlying deposited securities, are exempt from Section 12(g).

4. Books and Records.

   (a) A reporting company must make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer and must devise and maintain a system of records that assures that:

      (i) transactions are executed in accordance with management's general or specific authorization;

      (ii) transactions are recorded as necessary,

         A. to permit preparation of financial statements in conformity with GAAP;

         B. to maintain accountability for assets;

      (iii) access to assets is permitted only in accordance with management's authorization; and

      (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to differences.

   (b) A reporting company must exercise its influence in good faith and to the extent reasonable to cause entities of which it holds 50% or less of the voting power to abide by such record-keeping obligations.

5. Proxy Solicitation. If an issuer's securities are registered under Section 12, the solicitation of stockholder votes is regulated under Section 14. "Solicitation" is construed to include a variety of stockholder communications. The proxy statement must comply with Schedule 14A which requires detailed disclosure relating to the issuer, its management, management compensation and the proposals to be submitted to a vote of stockholders. (See X above.)

6. Insider Reporting and Trading — Section 16. If securities are registered under Section 12, stockholders holding in excess of a 10% interest, directors and officers (collectively, "Insiders") must file an initial ownership report on Form 3 and periodically report certain subsequent ownership changes on Form 4. Form 4 must be filed before the end of the second business day following the date of execution of any transaction resulting in a change in beneficial ownership; however, the SEC may establish alternative filing deadlines if the SEC determines the two business day filing deadline is not

feasible. An Insider is also required to file an annual report on Form 5 for exempt transactions and any transactions not previously reported for the fiscal year because of a failure to file a required Form 4 or because deferred reporting of such transaction is permitted. Late filings of Forms 3, 4 and 5 are required to be disclosed in the issuer's proxy statement. In addition, profits realized by an Insider on trades within a six month period (i.e., short swing profits) are recoverable under Section 16(b). An exception is available for a statutory insider who becomes a "forced seller" of securities in a merger or sale of assets transaction. Beginning not later than July 30, 2003, these filings will be required to be made on EDGAR, not in paper form, and posted on the issuer's website.

7. Rule 10b-5 (anti-fraud rule).

(a) The provisions of Section 10(b) of the 1934 Act and Rule 10b-5 thereunder apply to purchases and sales of securities and are anti-fraud provisions designed to prohibit "any manipulative or deceptive device or contrivance." They generally require "full disclosure" in connection with the purchases and sales of securities, including those in connection with the purchase or sale of a business.

(b) It is a violation of Rule 10b-5 to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

(c) Since its adoption, Rule 10b-5 has been the basis of many SEC and private proceedings, primarily in the areas of market manipulation, insider trading and corporate misstatements or omissions in connection with the sale of a security. The United States Supreme Court in Basic v. Levinson, 485 U.S. 224 (1988), reviewed the materiality standard in the context of merger discussions. The Court rejected the "bright line" standard that merger discussions be disclosed when an agreement in principle is reached regarding price and structure. Instead it adopted a materiality standard requiring evaluation of the facts and circumstances of a proposed merger in view of the probability that the merger would be consummated and the significance of the merger to the issuer.

8. Insider Trading Penalties.

(a) A civil penalty of up to three times the profit gained or loss avoided may be imposed against any person who has violated the 1934 Act by (x) purchasing or selling securities, on or through the facilities of a national securities exchange or from or through a broker or dealer, while in possession of material, non-public information, or (y) communicating material, non-public information in connection with any such purchase or sale of securities. A civil penalty of the greater of (x) $1,000,000, or (y) three times the profit gained or loss avoided may be imposed upon any controlling person who (A) knew or recklessly disregarded the fact that the controlled person was likely to engage in the actions constituting the violation and failed to take prophylactic action, or (B) knowingly or recklessly failed to establish, maintain or enforce prescribed policies and procedures reasonably designed to prevent insider trading violations by employees, which failure substantially contributed to or permitted the violations.

(i) Violations pursuant to public offerings by an issuer are excluded.

(ii) The SEC may bring administrative actions for violations of the 1934 Act. Any person who does not cooperate may be subject to a $1,000 fine and/or imprisonment of up to one year.

(b) A private right of action is available against any person who purchases or sells securities while in possession of material, non-public information. Recovery is limited in that:

(i) the total amount of damages recoverable shall not exceed the profit gained or loss avoided in the transactions that are the subject of the violation;

(ii) a controlling person is not liable so long as it acted in good faith and did not directly or indirectly induce the violative actions; and

(iii) the amount of damages shall be reduced by amounts disgorged pursuant to any SEC administrative action.

(c) The statute of limitations for insider trading actions is five years.

9. Prohibited Foreign Trade Practices.

(a) Officers, directors, employees, agents, and stockholders acting on behalf of a reporting company and the company itself are prohibited from corruptly using the mails or instrumentalities of interstate commerce in furtherance of an offer, payment, promise to pay, or authorization of the payment of money, or offer, gift, promise to give, or authorization of the giving of anything of value to certain foreign entities for the purpose of influencing acts or decisions in order to assist the issuer in obtaining or retaining business. The foreign entities include:

(i) officials of a foreign government;

(ii) a foreign political party or candidate for foreign political office; and

(iii) any other person with knowledge that the payment will be given to a foreign official, government, party or candidate.

(b) A reporting company may be fined up to $2,000,000 and persons acting on its behalf may be fined up to $100,000 or imprisoned for up to five years, or both, in addition to civil liabilities.

(c) Non-reporting domestic business concerns are also subject to the same prohibitions, administered by the Department of Justice ("DOJ").

C. Investment Company Act of 1940 (the "1940 Act").

1. The 1940 Act requires that a company that issues or proposes to issue securities must register with the SEC as an investment company if its business fits the description set forth in the 1940 Act.

Registered investment companies are subject to extensive reporting requirements and to substantive regulation of many of their activities in addition to the requirements of the 1933 Act and the 1934 Act.

Investment companies subject to the 1940 Act include issuers that are engaged in the business of investing in, holding or trading securities but exclude United States regulated banks, insurance companies and companies engaged primarily in real estate activities.

2. The term "securities" is interpreted broadly and includes loans and other evidences of indebtedness. Unlike the 1933 and 1934 Acts, the 1940 Act makes no distinction between securities held for investment and those arising out of commercial transactions.

3. Under certain provisions of the 1940 Act, the determination as to what constitutes an investment company depends on the mix of assets shown on an issuer's balance sheet. Generally, an issuer may be deemed to be an investment company if "investment securities" (that is, securities other than those issued by the United States Government and a limited number of other entities) make up more than 40% of its total assets, although some exceptions are available.

(a) An issuer may become an investment company, even inadvertently, in several ways. For instance it may:

(i) merge into, or acquire and merge into itself, an investment company whose asset mix is such that more than 40% of the surviving company's assets consist of investment securities; or

(ii) restructure its business or operations; i.e., by spinning off or selling a division or a portion of its assets or by moving assets into a subsidiary (note that the quantifying of assets for purposes of the 1940 Act is generally done on an unconsolidated basis).

(b) Holding companies, however, are not deemed to be investment companies if their subsidiaries are not themselves investment companies.

4. If the company falls within the definition of "investment company," it is important to review the possible exceptions and exemptions from registrations (this is an area where it is helpful to consult with an expert). Some frequently used exceptions include (a) companies with 100 or fewer beneficial security holders (or an unlimited number of qualified institutional investors) which do not publicly offer their securities; this is the exemption used for venture and hedge funds; and (b) companies that are "primarily engaged" in a business other than investing securities.

5. Prior to offering their securities for sale in the United States, foreign companies that are investment companies under the 1940 Act may seek a discretionary exemption under Section 6(c) of the 1940 Act by filing an application with the SEC (unless a statutory exclusion is available).

6. It should be noted that when entering into a transaction, it is advisable to ascertain whether the other party thereto is or may be an investment company. In addition to other restrictions, the 1940 Act provides that an unregistered investment company may not engage in any business in interstate commerce and there is a specific provision stating that contracts entered into by unregistered investment companies may be voidable in certain contexts.

D. Sarbanes-Oxley Act of 2002

1. Overview. The Sarbanes-Oxley Act amended various terms of the existing securities laws and added several new provisions, including increased enforcement powers for the SEC and criminal penalties. Most of the provisions apply to any issuer that has securities registered under Section 12 of the 1934 Act or that has registered securities under the 1933 Act, but some only apply to companies listed on a national securities exchange or quoted on Nasdaq.

2. Certification of Periodic Reports. All periodic reports on Forms 10-K, 10-Q, 20-F and 40-F require the CEO and CFO of the issuer to provide two specific certifications as to the accuracy of the information contained in the Form, including the financial statements:

   (a) Civil Certification – The exact form of this certification is specified by regulation, and cannot be varied even slightly. It addresses several issues, including the accuracy of the financial statements and maintenance of internal controls.

   (b) Criminal Certification – This separate certification requires the CEO and CFO to certify (i) that the periodic report fully complies with the requirements of Section 13(a) or 15(d) of the 1934 Act and (ii) that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer. A person who makes this certification knowing that the periodic report does not comport with all these requirements can be fined up to $1,000,000 or imprisoned up to 10 years, or both, while someone who does so "willingly" can be can be fined up to $5,000,000 or imprisoned up to 20 years, or both.

3. Prohibition of Loans. Issuers that have securities registered under Section 12 of the 1934 Act or that have registered securities under the 1933 Act are prohibited from extending or arranging credit in the form of a personal loan to any director or executive officer of the issuer. There are certain exceptions, such as home improvement loans and charge cards made in the ordinary course of the issuer's business on terms no more favorable than those offered by the issuer to the public. Also, U.S. banks regulated by the Federal Reserve are exempted from this provision to the extent that a loan is subject to the insider lending restrictions of section 22(h) of the Federal Reserve Act. Loans that were outstanding at the time this provision was passed are grandfathered, but if they are extended or renegotiated then they would become subject to this provision.

4. Forfeiture of Bonuses and Profits. If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the CEO and CFO must reimburse the issuer for:

(a) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the SEC (whichever first occurs) of the financial document embodying such financial reporting requirement; and

(b) any profits realized from the sale of securities of the issuer during that 12-month period.

5. Audit Committees and Financial Experts. Issuers listed on a national securities exchange or quoted on Nasdaq are required to have independent audit committees, containing at least one financial expert. All issuers that have securities registered under Section 12 of the 1934 Act or that have registered securities under the 1933 Act are required to disclose whether they have independent audit committees and financial experts, and if not, why not.

   Under the Sarbanes-Oxley Act, the SEC is required to issue rules by April 26, 2003 prohibiting NYSE, AMEX and the Nasdaq-NMS from listing a company whose audit committee members are not independent, which means they may not accept any consulting, advisory or other compensatory fee from the company or be an "affiliated person" of the company or any subsidiary. In addition, both NYSE and the Nasdaq-NMS have proposed rules that would require listed companies, other than controlled companies, to have a majority of independent directors.

6. Code of Ethics. Issuers that have securities registered under Section 12 of the 1934 Act or that have registered securities under the 1933 Act are required to disclose whether they have a code of ethics, and to disclose any changes thereto.

7. Insider Trades during Pension Fund Blackout Periods. The Sarbanes-Oxley Act prohibits the directors and executive officers of an issuer that has securities registered under Section 12 of the 1934 Act or that has registered securities under the 1933 Act, from, directly or indirectly, purchasing, selling or otherwise acquiring or transferring any equity security of the issuer during a pension plan blackout period that prevents plan participants or beneficiaries from engaging in equity securities transactions, if the equity security was acquired in connection with the director or executive officer's service or employment as a director or executive officer. In addition, the SEC has proposed rules that would specify the content and timing of the notice that issuers must provide to their directors and executive officers and to the SEC about a blackout period.

E. Overview of State Securities Laws.

1. Each of the 50 states, the District of Columbia, Guam and Puerto Rico regulate securities transactions pursuant to "blue sky" laws, unless preempted by Section 18 of the 1933 Act.

   (a) Such laws contemplate, almost without exception, the regulation of both:

      (i) persons effecting transactions in securities (usually as broker-dealers or agents); and

      (ii) the securities themselves, other than securities defined under Section 18 of the 1933 Act as "covered securities" or securities that will be "covered securities" upon the completion of the transaction. For this purpose, "covered securities" are securities listed or authorized for listing on the NYSE, AMEX, or the Nasdaq-NMS and any security of the same issuer that is equal in seniority or that is senior to a listed security.

   (b) Generally a state's law will apply where there has been geographical contact with that state in connection with a securities transaction.

   (c) Although almost 40 states have adopted or substantially adopted the Uniform Securities Act:

      (i) most enacting legislatures have modified the Uniform Securities Act in some way;

      (ii) regulations promulgated under the Uniform Securities Act vary widely from state to state; and

      (iii) many areas within the law are subject to the discretion of the state securities administrator.

2. In most jurisdictions issuers dealing in their own securities (and employees of such issuers who are not compensated for their securities-related activities) are not subject to affirmative regulation because:

   (a) issuers and their representatives are expressly excluded from the definition of broker-dealer and agent, respectively;

   (b) such persons are, by virtue of the type of security or transaction, either:

      (i) excluded from the definition of broker-dealer or agent; or

      (ii) exempted from the applicable registration requirements;

   (c) activities in a state are minimal and an administrator having the authority has issued a "no action" letter or otherwise waived regulatory requirements.

3. Almost every state requires that securities, other than "covered securities", offered or sold in such state be registered unless such security or the transaction in which it is offered or sold is exempt.

   (a) There are two common types of securities registration provisions:

      (i) securities registration by coordination which may be subject to merit review by a state. Registration by coordination is used for a security for which a registration statement has been filed under the 1933 Act. The filing under these provisions automatically becomes effective at the moment the Federal registration statement becomes effective if all conditions are satisfied; and

      (ii) registration by qualification, by which states review the offering in greater depth. In many cases, such offerings have not been subject to SEC review.

   (b) States generally apply either of the following approaches to registration:

      (i) fair, just and equitable disclosure, which is applied by most states, and issues that have not been raised by the SEC are rarely raised; and

      (ii) full and fair disclosure, which reviews the merits of an offering and may require undertakings or other action by the issuer or affiliated persons. This approach is being followed increasingly.

   (c) Exemptions from state registration provisions for "non-covered securities" are based on the nature of the securities being offered or sold, such as securities the issuance of which are regulated by a governmental authority.

   (d) Exemption from state registration provisions may be:

      (i) automatic;

      (ii) effective subject to compliance with filing provisions; or

      (iii) available upon application and approval by the state.

4. Under "blue sky" law, broad anti-fraud provisions are applicable notwithstanding exemptions from any or all registration or filing provisions. This is true even if the securities in question are "covered securities".

XVI. <u>OVERVIEW OF FEDERAL ANTITRUST LAWS</u>.

A. <u>Clayton Act</u>.

1. <u>Prohibited Acquisitions</u>. Section 7 of the Clayton Act prohibits acquisitions of stock or assets, including acquisitions of firms making or selling competing products ("horizontal acquisitions") or complementary products (e.g., of customers or suppliers) ("vertical acquisitions"), which may substantially lessen competition or tend to create a monopoly. Acquisitions of unrelated businesses ("conglomerate acquisitions") are generally not challenged. Proof of actual anticompetitive effects is

not required. It is enough to show that anticompetitive effects (e.g., higher prices, less output, less innovation) would likely result if the acquisition were allowed; in horizontal mergers, that showing is usually made by showing a significant increase in market concentration.

2. Interlocking Directors and Officers. Section 8 of the Clayton Act prohibits individuals from serving as directors or board-appointed officers of two corporations that have capital, surplus and undivided profits in excess of $10,000,000 and competing sales of at least $1,000,000. (These two figures are adjusted up or down each year by the percentage rise or fall in the GNP). The prohibition will not apply if the competitive sales account for less than 2% of one company's sales or less than 4% of each company's sales.

3. Who may sue. Civil suits under the Clayton Act may be brought by the Antitrust Division of the U.S. Department of Justice, the FTC, Attorneys General of the U.S. states, or private parties injured in their business or property. The FTC may enforce the Clayton Act in administrative proceedings. The Clayton Act is not enforced criminally.

B. Sherman Antitrust Act.

1. Violations of Sections 1 and 2 may be asserted by way of criminal indictment, or by civil complaint by the Federal government, state attorneys general or private persons "injured in their business or property." Conduct that violates the Sherman Act may be challenged by the FTC as a violation of Section 5 of the FTC Act (see below).

2. Section 1 prohibits contracts, combinations or conspiracies in restraint of trade. *Per se* violations, in particular price fixing and the allocation of markets or customers, may result in criminal prosecution. Conduct that "unreasonably" restrains trade in the totality of the circumstances is typically not prosecuted criminally, but may be the subject of civil suit. Section 1 does not prohibit wholly unilateral action.

3. Section 2 prohibits monopolization and attempts to monopolize. The elements of an offense include:

   (a) the possession of monopoly power to control price, lower output or exclude competition in the relevant market, or (for attempt) a dangerous likelihood of achieving monopoly power; and

   (b) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior skill, foresight or industry.

4. Penalties in criminal cases brought by the government may include prison terms, fines, and debarment from doing business with the U.S. government. Penalties in civil cases brought by injured persons may include treble damages.

C. Federal Trade Commission Act.

1. Section 5 of the Federal Trade Commission Act has been used by the FTC as a ground to challenge mergers and acquisitions, as well as anticompetitive conduct. Section 5 prohibits unfair methods of competition, and unfair or deceptive acts or practices. in or affecting commerce in the United States. Section 5 is enforced through administrative proceedings before the FTC, or in injunction proceedings by the FTC in Federal court. There is no private right of action under Section 5.

2. As a general matter, conduct or acquisitions that violate the Sherman Act can also be held to violate the FTC Act. Conduct that does not violate the Sherman Act may nonetheless violate the FTC Act if the conduct has an actual anticompetitive effect.

3. FTC administrative proceedings may result in a cease and desist order (including divestiture of acquisitions). Violation of an FTC order may lead to a civil penalty action in Federal court. The FTC may also seek "disgorgement" of anticompetitive profits in actions in Federal court.

D. Application to Foreign Commerce. The U.S. antitrust laws apply to U.S. interstate commerce, to U.S. import commerce, to U.S. export commerce (e.g. cartels in foreign nations intended to restrict the importation of U.S. goods into those markets), and to other conduct, including mergers, with significant effects on U.S. interstate or foreign commerce.

E. Merger Guidelines. The Antitrust Division and the FTC have jointly issued guidelines setting forth the methodology they will use in determining whether proposed mergers or other combinations are likely to be challenged as violating the Federal antitrust laws.

1. Horizontal Mergers and Acquisitions. The Federal antitrust agencies analyze mergers by examining market concentration, entry conditions, the likelihood of anticompetitive effects, and efficiencies. State antitrust authorities and courts tend to place greater weight on market concentration and less weight on other factors.

(a) The analysis of market concentration generally begins with market definition, both as to product and geography. The market is defined by determining to which products or suppliers customers would turn in the event of a small but significant, nontransitory price increase (typically 5-10% for one year). Company perceptions of the competition it faces, as reflected in ordinary course of business documents, are probative, as are customer opinions.

(b) Once the market is defined and market shares estimated, concentration is measured using the "Herfindahl-Hirschman Index" ("HHI") which reflects market concentration. To determine a particular market's HHI, the market share of each company in the relevant market must be squared. Then the squares are added together. For example, if there are 10 companies in a relevant market, each having a market share of 10%, the HHI would be 1,000.

(c) Market concentration has been divided into three categories:

(i) Unconcentrated (HHI below 1,000);

(ii) Moderately concentrated (HHI between 1,000-1,800); and

(iii) Highly concentrated (HHI above 1,800).

(d) According to the Guidelines, a merger, acquisition or other combination in an unconcentrated market is unlikely to have adverse competitive effects, but transactions in moderately and highly concentrated markets are regarded as potentially raising significant competitive concerns if the increase in concentration caused by the transaction exceeds 100 points.

(e) The Guidelines provide an analytical framework to be used by the antitrust agencies for determining whether to challenge a proposed transaction. In addition to market concentration and market shares, the other steps in the analysis include:

(i) examination of the competitive effects of the proposed transaction (the possibility of unilateral exercise of market power by the merged firm, or of coordinated interaction among that firm and its remaining competitors in the market);

(ii) the possibility of timely, likely and sufficient new entry following the transaction;

(iii) significant efficiencies that are likely to be achieved through the transaction; and

(iv) proof that the target is a failing firm that would otherwise exit the market (and that there is no less anticompetitive merger).

2. Non-Horizontal Mergers and Acquisitions. Non-horizontal mergers and acquisitions (i.e., vertical and conglomerate) may be, but are not generally, challenged. Most vertical mergers that have been challenged involve the combination of a strongly dominant firm with one of a small number of competing customers (or suppliers).

3. Remedies. The government (or another plaintiff) may challenge a merger before it is consummated and seek an injunction blocking the merger. The government (including state Attorneys General) may also challenge a merger after it is consummated, seeking divestiture. However, most merger

challenges are resolved through consent decrees. Merger consent decrees generally require that overlapping businesses or smaller sets of assets be sold to competitively suitable acquirers approved by the antitrust agency. The agencies have from time to time agreed to allow mergers to proceed with behavioral remedies.

F. Antitrust Guidelines for Collaborations Among Competitors.

The DOJ and FTC "Antitrust Guidelines for Collaborations Among Competitors" provide guidance on agreements between competitors that would reduce price, output or innovation competition, or allocate markets or customers (the "restraint"), in the context of joint ventures and other collaborative activity. The Collaboration Guidelines attempt to distinguish joint ventures and other collaborations from (1) complete integrations, which are analyzed as mergers, and (2) "naked restraints" such as price-fixing agreements that are not part of procompetitive collaboration.

1. Threshold Inquiry. Does the *collaboration* involve an efficiency-enhancing integration of economic activity? If so, *restraints* reasonably related to the integration and reasonably necessary to achieve the integration are examined under the rule of reason, even if they would be *per se* violations but for the presence of integration.

   (a) To show efficiency-enhancing integration, it is not necessary to combine two businesses in a legal entity such as an LLC. Integration may be by contract or informal. What is significant is whether there is an integration of economic activity or risk *beyond* the integration of decision-making regarding price, output levels, or other coordination of decision-making.

   (b) Absent efficiency-enhancing integration, an agreement among competitors to fix price (including on purchases of inputs, as well as sales of products) or allocate customers or markets is likely to be treated as a *per se* violation.

2. If efficiency-enhancing integration is shown:

   (a) If the market shares of the participants and the collaborative entity together account for not more than *20% of each relevant market* (e.g., product, technology) in which competition may be affected, the restraint falls within a safe harbor and no further analysis is generally necessary.

   (b) For research and development collaborations, when *three or more* independently controlled research efforts, in addition to those of the collaboration, possess the required specialized assets or characteristics and the incentive to engage in research and development that is a close substitute, the restraint is within a safe harbor.

   (c) If the collaboration does not fall within the safe harbor, the restraint is analyzed under the rule of reason, and the procompetitive benefits of the collaboration are balanced against the anticompetitive harms resulting from the restraint.

G. Hart-Scott-Rodino Filing Requirements.

1. Purpose of Act.

   (a) The HSR Act requires parties to certain proposed stock or asset transactions to file Premerger Notification and Report Forms (the "HSR Report") with the FTC and DOJ prior to consummation, and to refrain from consummating the transaction until after the expiration of specified "waiting periods."

   (b) The reason for such premerger notification is to permit the antitrust agencies to examine the proposed transaction to determine whether it will, if consummated, violate the Federal antitrust laws. The Hart-Scott-Rodino Act is not a limitation on the scope of the Clayton Act. Transactions that are not subject to HSR reporting may be (and have been) challenged by the antitrust agencies.

(c) If an antitrust agency concludes that consummation of the transaction would constitute a violation, it may seek to enjoin it. The agency, however, is not required to attack the transaction during the waiting period, but may institute litigation based upon alleged violations of the Federal antitrust laws, including the HSR Act itself, after consummation.

(d) A failure to comply with the HSR Act subjects entities, officers and directors to civil penalties of at least $11,000 a day, until there is compliance. "Failure to comply" generally means making an acquisition without complying with the Act. However, the FTC might take the position that noncompliance with the regulations (for example, by making a misstatement) constitutes a violation even absent an acquisition. The DOJ may prosecute false statements in HSR filings under 18 U.S.C. § 1001.

(e) The HSR Act was substantially amended, effective February 1, 2001, for the first time since its original enactment. The amendments changed the filing thresholds and imposed a three tiered filing fee requirement based on the value of the transaction.

2. Transactions Which Must Be Reported. Only transactions among parties which satisfy the "Commerce" test and which are large enough to satisfy specified thresholds contained in the HSR Act and rules promulgated thereunder ("HSR Rules"), must be reported prior to consummation.

Only those transactions that would result in the acquirer holding stock or assets valued at $50 million or more must be reported. If the value floor is met, the first determination to be made is the identity of the "ultimate parent entity" of both the acquiror and the target. "Ultimate parent entity" is defined as "an entity which is not controlled by any other entity." "Control" is defined as holding 50% or more of the voting securities of a corporation or, in the case of an unincorporated entity, having the right to 50% or more of the profits or of the assets upon dissolution or in the case of either corporations or unincorporated entities having the contractual power to designate 50% or more of the board of directors or a comparable group.

The ultimate parent entities of the acquiror and the target, together with all entities directly or indirectly controlled, are the "Acquiring Person" and the "Acquired Person," respectively, for purposes of the HSR Act.

3. Statutory Filing Requirements.

(a) Commerce Test. This test is satisfied if either the Acquiring Person or the Acquired Person is engaged in commerce in the United States or an activity affecting commerce in the United States.

(b) The HSR Act provides three reporting tiers:

(i) No filing is required if the stock or assets to be held as a result of the transaction are valued at less than $50 million;

(ii) If the value of stock or assets to be held is between $50 and $200 million, a filing is required only if the "Size-of-Person test" described below is met;

(iii) A filing is required if the value of the stock or assets to be held is valued in excess of $200 million, whether or not the "Size-of-Person" test is met.

(c) If the Acquiring Person is larger than the Acquired Person, the Size-of-Person test is satisfied only if the Acquiring Person has total assets or annual net sales of $100 million or more and the Acquired Person:

(i) if engaged in manufacturing, has total assets or annual net sales of $10 million or more; or

(ii) if not engaged in manufacturing, has total assets of $10 million or more.

(d) If the Acquiring Person is smaller than the Acquired Person, the Size-of-Person test is satisfied only if the Acquiring Person has total assets or annual net sales of $10 million or more, and the

Acquired Person, regardless of whether it is engaged in manufacturing, has total assets or annual net sales of $100 million or more.

(e) Despite the fact that foreign sales are not reported in the HSR Report, foreign assets and foreign annual net sales are included in determining whether a party satisfies the Size-of-Person test.

4. Notification Thresholds. The HSR Regulations provide five "notification thresholds"; and HSR filing is required each time a higher notification threshold would be met or crossed. Without these notification thresholds, the statutory thresholds arguably would mandate a filing for each incremental acquisition of stock or assets. The five notification thresholds are:

(a) The stock or assets to be held are valued between $50-100 million;

(b) The stock or assets to be held are valued between $100-500 million;

(c) The stock or assets to be held are valued at $500 million or more;

(d) 25% of the outstanding voting securities will be held and are valued at $1 billion or more; and

(e) 50% of the outstanding voting securities will be held and are valued at $50 million or more.

5. Valuation. The "value" of the stock or assets to be acquired determines both whether a notification threshold will be met and the amount of the filing fee that must be paid.

(a) Asset acquisitions. The value of assets is the greater of Fair Market Value or Acquisition Price, if one had been determined.

(i) Fair Market Value "must be determined in good faith, by the board of directors of the Acquiring Person, no more than 60 days before filing (if one is required) or the closing date (if no filing is required)." The rules do not specify a valuation or accounting technique to be used.

(ii) Acquisition Price is the aggregate of all consideration, which includes accrued liabilities to be assumed and non-compete agreements.

(b) Stock acquisitions. The value of voting securities is the value of all voting securities that will be held and depends on whether the stock is publicly traded and whether the acquisition price has been determined.

(i) Publicly traded stock. The value of shares to be acquired is the greater of Market Price or Acquisition Price, or if neither can be determined, Fair Market Value.

A. For open market purchases, tender offers, conversions or exercises of options or warrants, Market Price is the lowest closing quotation or bid price during the 45-calendar days prior to the HSR filing, if filing is required, or prior to closing, if filing is not required.

B. For agreed transactions, Market Price is the lowest closing quotation during the 45-calendar days beginning one day before execution of the agreement.

C. Acquisition Price is the aggregate of all consideration to be paid.

(ii) Stock not publicly traded. The value of the transaction is the Acquisition Price if determined. If not, Fair Market Value is used.

(iii) Previously acquired stock is valued at Market Price or Fair Market Value if Market Price is indeterminable (if publicly traded) or Fair Market Value (if not publicly traded). The value of the transaction is the sum of values of the previously held shares and the additional shares to be acquired. If the previously acquired securities were the subject of an HSR filing, these shares are aggregated solely to determine if a new threshold will be met or exceeded.

(c) Prior acquisitions from the same Acquired Person must be aggregated in certain circumstances to determine value.

6. Exemptions. As a general rule, an HSR Report Form must be filed each time an Acquiring Person will meet or exceed a threshold for the first time or the next higher notification threshold in subsequent acquisitions. Certain transactions need not be reported if they come within exemptions provided by the HSR Act and Rules.

(a) "Investment" Exemption.

(i) An Acquiring Person may acquire, without filing premerger notification, up to 10% of an issuer's outstanding voting securities, regardless of their value, if the securities are to be held "solely for the purpose of investment."

(ii) "Solely for the purpose of investment" is defined as having "no intention of participating in the formulation, determination or direction of the basic business decisions of the issuer."

(iii) The antitrust enforcement agencies take a very strict view of this exemption and have challenged violations.

(b) Exemptions for Goods and Realty. Certain acquisition of goods and realty "in the ordinary course of business" are exempt from HSR reporting requirements. The exemption generally does not apply to acquisitions of all or substantially all of the assets of an "operating unit."

(i) Exempt goods include new goods and current supplies (e.g., inventory, raw materials and used durable goods).

(ii) Certain realty is exempt whether or not it constitutes an "operating unit", including unproductive real property, office or residential property, hotels, recreational land (e.g. golf courses), agricultural property, retail rental space and warehouses (including shopping centers), investment rental property acquired by institutional investors and certain carbon based mineral reserves.

(c) Convertible Instrument Exemption. Acquisitions of convertible securities do not require premerger notification unless they convey voting power. The subsequent conversion of the securities into a voting security is an event that may trigger HSR notification.

7. Foreign Parties.

(a) Acquisition of Foreign Assets. If non-U.S. assets are being acquired, a filing is required if the assets had sales of more than $50 million in or into the U.S. during the most recent financial year.

(b) Acquisitions of Foreign Securities. By U.S. Persons. An acquisition by a U.S. Person of the voting securities of a foreign issuer is exempt unless the issuer and all entities which it controls either:

A. Hold assets located in the U.S. (other than investment assets or securities of another person) with a total value of over $50 million, or

B. Made sales of over $50 million in or into the U.S. in its most recent fiscal year.

(ii) By Foreign Persons. An acquisition by a foreign person of voting securities of a foreign issuer is exempt if it will not confer control of an issuer:

A. Which holds assets located in the U.S. (other than investment assets or securities of another person) having an aggregate value of over $50 million, or

B. Made sales in or into the U.S. of over $50 million in its most recent fiscal year.

(c) Any acquisition is exempt if both parties are foreign, together they do not have either sales in or into the U.S. or U.S. assets (other than investment assets) aggregating less than $110 million and the value of the transaction is $200 million or less.

8. Who Must Report.

(a) HSR Reports must be filed by both the Acquiring Person and the Acquired Person.

(b) The HSR Report of an Acquiring Person must be accompanied by a filing fee, depending on the value of the transaction:

(i) For transactions valued between $50 and $100 million, the fee is $45,000.

(ii) For transactions valued between $100 and $500 million, the filing fee is $125,000.

(iii) For transactions valued at $500 million or more, the filing fee is $280,000.

(c) If, as a result of the acquisition, the Acquiring Person will hold 50% or more of the voting securities of an issuer, and if that issuer holds voting securities of another company ("secondary issuer") which exceeds a notification threshold (but does not exceed 50% of the secondary issuer's outstanding voting securities), the acquisition of the secondary issuer's securities is deemed to be a "secondary acquisition." Both the Acquiring Person and the secondary issuer must file notification prior to consummation of the primary transaction.

(d) Compliance with the HSR Act is also required in connection with the formation of a new corporation or corporate joint venture, provided certain tests are satisfied relating to the size of the parties and the size of the new company.

(e) The formation of a LLC is potentially reportable if two or more pre-existing separately controlled businesses will be contributed to the LLC and one of the members will control the LLC. The formation of a partnership is not a triggering event under HSR; if, however, 100% of a partnership is being acquired it is treated as a potentially triggering acquisition of assets.

9. Waiting Period.

(a) Commencement of Waiting Period.

(i) The waiting period for transactions identified in Section 801.30 of the HSR Rules (e.g., tender offers, secondary acquisitions, open market purchases and other acquisitions of securities from persons other than the ultimate parent entity of the issuer) commences upon the filing of notification by the Acquiring Person, with notice to the Acquired Person.

(ii) The waiting period for all other transactions (e.g., acquisition from the issuer, mergers and consolidations) commences upon the filing of notification by all parties to the transaction.

(iii) If any waiting period would end on a Saturday, Sunday or holiday, it is extended to the next business day.

(b) Duration and Termination of Waiting Period.

(i) Duration.

A. the initial waiting period is 15 days for cash tender offers and 30 days for all other transactions. These waiting periods may be extended if the antitrust agency which is reviewing the filing requests additional information from any of the parties to the transaction (a "Second Request"). The tender offer waiting period also covers a subsequent clean-up merger.

B. acquisitions of assets or voting securities subject to Section 442 of the Bankruptcy Code are subject to a 15 day waiting period.

(ii) Extension. If a Second Request is issued, the waiting periods will not terminate until after "substantial compliance" with the request:

A. in the case of a cash tender offer, 10 days after receipt by the agency of the additional information requested (there are, however, certain exceptions); and

B. in all other cases, 30 days after receipt by the agency of all additional information requested.

(iii) Early Termination. The antitrust agencies may agree to grant early termination of the waiting period. There is no need to demonstrate a "special business reason" for a request for early termination. If early termination is granted, that fact will be published on the FTC's website (www.ftc.gov) and in the Federal Register. No notification of the filing is published otherwise.

(c) Acquisitions Subsequent to the Waiting Period. Once the waiting period imposed by the HSR Act has expired or been terminated, the Acquiring Person has one year to cross the threshold for which such notification was filed.

(i) If the Acquiring Person crosses the threshold for which such notification was filed, the Acquiring Person may (for a period of five years from the termination of the waiting period) continue to acquire assets or voting securities of the Acquired Person so long as it does not meet or exceed the next notification threshold.

(d) "Gun-jumping." Prior to expiration of the waiting period, the acquirer may not consummate the acquisition; may not exercise control of the acquired entity (by, for example, directing its business decisions), and may not agree with the acquired entity as to prices, output, innovation, etc. Integration of business activity in advance of the expiration of the waiting period has been challenged as a violation of the HSR Act.

10. Confidentiality.

(a) The HSR Act affords significant protection from disclosure of the information and documentary material filed with the FTC and DOJ.

(b) As a general proposition, the antitrust agencies may not publicly disclose the information and documentary material which has been filed, and such information and material is exempt from disclosure under the Freedom of Information Act.

(c) The HSR Act specifically provides that such information or documentary material may be disclosed to Congress or to any duly authorized committee or sub-committee of Congress. Such disclosure is, in practice, extremely rare.

(d) Such information or documentary material may be made public in connection with any administrative or judicial action or proceeding brought by the Federal government. Although neither the HSR Act nor the Rules provide for prior notification of disclosure in connection with such actions or proceedings, the agencies, in a formal interpretation, have advised that, whenever possible, 10 days' prior notice will be given.

(e) In the context of private litigation, such as resistance to a tender offer by the target, the HSR Report and the documents filed with the Federal government are not immune from disclosure during pre-trial discovery.

11. HSR Report Form. The HSR Report must be filed either by or on behalf of each ultimate parent entity and requires the following disclosure:

(a) Certain background information concerning the ultimate parent entity, the person filing the Report (if different from the ultimate parent entity) and the nature of the transaction.

(b) A description of the proposed transaction and of the assets and/or voting securities to be acquired, including the filing of executed copies of the related contracts, agreements in principle, and/or letters of intent.

(c) Filing of documents, including public disclosure documents, annual reports and other financial documents, and "4(c) documents" consisting of "all studies, surveys, analyses and reports which were prepared by or for any officer(s) or director(s) . . . for the purpose of evaluating or analyzing the acquisition with respect to market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets . . . ." The HSR Act requires a thorough search for 4(c) documents. The antitrust agencies have taken the position that a failure to produce 4(c) documents means that the HSR filing was incomplete and the waiting period, therefore, is still open. When a transaction has closed and the agencies subsequently discover that 4(c) documents were not filed, the agencies have sought stiff enforcement actions, including seeking four years of daily penalties, divestiture and disgorgement of anticompetitive profits.

(d) Annual dollar revenue data of the reporting company, using North American Industry Classification System or "NAICS" codes, for its operations conducted in the United States for base year 1997 and for the most recent year.

Information must be supplied using 6-digit NAICS national industry codes for all operations. In addition, to the extent revenues are generated for manufacturing operations in the U.S., data must also be supplied at the 7-digit NAICS product class level (for the most recent year) and the 10-digit NAICS product code level (for 1997). Information concerning NAICS can be found at the Department of Census website (http://www.census.gov/epcd/www/naics.html). The Acquired Person is required to report U.S. revenues only for the entity being sold.

(e) Identification of all subsidiaries, all stockholders that hold 5% or more of the outstanding voting securities of the ultimate parent entity or any subsidiary of the ultimate parent entity, and all companies in which the ultimate parent entity or its subsidiaries hold between 5% and 50% of the outstanding voting securities (information on entities with total assets less than $10,000,000 need not be reported and the Acquired Person is required to provide information only for the entity being sold) in stock transactions.

(f) Common (6-digit NAICS codes of all parties to the transaction) and, for such overlapping codes, geographic information on United States operations.

(g) Certain acquisitions by the Acquiring Person during the last five years in any industry in which the target is also engaged.

XVII. REGULATION OF FOREIGN INVESTMENT OR OWNERSHIP.

There are restrictions on foreign investment in the United States at both the Federal and the state levels. Federal regulation focuses on certain "key sectors," reporting requirements and national security considerations. State regulation focuses on investments in land, natural resources and banking activities.

A. National Security Review of Foreign Acquisitions.

1. Committee on Foreign Investment in the United States. The Committee on Foreign Investment in the United States ("CFIUS") is an interagency body established by Executive Order in 1975 in response to concerns at the time about Arab investment in the United States. CFIUS was directed to monitor the impact of foreign investment in the United States, both direct and portfolio, and coordinate implementation of United States policy concerning foreign investment. CFIUS had no authority to approve or disapprove foreign investments in the United States, and it had no legal mandate to block transactions. CFIUS now has authority to implement Section 721 of the Defense Production Trade Act, as discussed below.

2. Section 721 of the Defense Production Act of 1950.

(a) Investigations. Section 721 of the Defense Production Act of 1950, as amended by Section 5021 of the Omnibus Trade and Competitiveness Act of 1988, authorizes the President or the President's designee to conduct an investigation to determine the effects on national security of mergers, acquisitions and takeovers proposed or pending on or after August 23, 1988 by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States. Under a 1992 amendment, investigations can be mandatory for certain transactions in which the foreign entity making the acquisition is controlled by a foreign government. If the President or his designee determines that an investigation should be undertaken, the investigation must be commenced within 30 days. If commenced, the investigation must be completed within 45 days, and a decision on whether to take action must be rendered within 15 days after completion of the investigation.

(b) Suspension or Prohibition of Takeovers. If the President finds that (1) there is credible evidence to believe that the foreign interest exercising control might take action that threatens to impair the national security, and (2) provisions of law, other than Section 721 and the International Emergency Economic Powers Act, do not provide adequate and appropriate authority to protect the national security, the President may take such action for such time as the President considers appropriate to suspend or prohibit the acquisition, merger or takeover. The President's findings are not subject to judicial review. The President may direct the Attorney General to seek appropriate relief, including divestiture, in a United States District Court in order to implement and enforce Section 721.

(c) Considerations. In determining whether a proposed transaction threatens to impair the national security, the President may consider, among other factors, domestic production needed for projected national defense requirements; the capability and capacity of domestic industries to meet national defense requirements and the control of domestic industries and commercial activity by foreign citizens as it affects the capability and capacity of the United States to meet the requirements of national security; the potential effects on sales of military equipment or technology to terrorist countries or countries of concern for nuclear, missile or chemical and biological weapons proliferation reasons; and the potential effects on United States international technological leadership in areas affecting national security. "National security" is not defined and, therefore, must be determined on a case-by-case basis.

(d) Delegation of Authority to CFIUS. On December 27, 1988, President Reagan signed an Executive Order delegating the authority to conduct national security reviews to CFIUS. The order directs CFIUS to determine whether to conduct an investigation within 30 days after receipt of written notification of a proposed transaction. If one or more members of CFIUS disagrees with a decision not to commence an investigation, the Chairman of CFIUS must submit a report to the President setting forth the differing views and presenting the issues for his decision. This referral must be made within 25 days after CFIUS receives notice of the transaction. The order also requires CFIUS to make a recommendation to the President upon completion or termination of an investigation. If CFIUS is unable to reach a unanimous recommendation, the Chairman's report to the President shall set forth the differing views and present the issues for his decision.

(e) Members of CFIUS. The Secretary of the Treasury is designated as the Chairman of CFIUS. Other members include the Secretaries of Commerce, Defense and State, the United States Trade Representative, the Chairman of the Council of Economic Advisers, the Attorney General, the Director of the Office of Management and Budget, the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs and the Assistant to the President for Economic Policy.

(f) Administration. The Treasury Department's Office of International Investment administers CFIUS reviews and investigations. Notification of transactions is voluntary. However, any transaction occurring on or after August 23, 1988 in which a foreign person obtains control of a United States company can be challenged by the President if notification has not been made and the statutory periods have not run. Information submitted in connection with a notification or investigation is confidential and may not be made public, except in connection with an administrative or judicial proceeding. Notification can be withdrawn by a party after submission without prejudice to that party's right to resubmit notice at a future date.

(g) Disclosure Requirements. Under Treasury Department regulations, information required for notification of a transaction includes detailed descriptions of:

(i) the transaction and the parties;

(ii) the assets being acquired (for asset acquisitions);

(iii) the business of the foreign party;

(iv) a list of each classified or other defense-related contract of the acquired company;

(v) the plans and intentions of the acquiring company;

(vi) the classification of commodities and technical data exported by the acquired company;

(vii) whether the acquiring company is acting on behalf of, or is controlled by, a foreign government; and

(viii) any other regulatory filings with respect to the transaction.

(h) Exclusions. The regulations specifically exclude certain transactions from the application of the statute such as the acquisition by a bank or insurance company of 10% or less of the outstanding voting securities of a United States company solely for purposes of investment. Start-up or "greenfield" investment also is not covered by the statute.

3. United States Export Controls Relating to Technology Transfers. The acquisition of a United States company by a foreign company may require a license to transfer technology. The United States Government has established a comprehensive system of controls over shipments of (x) commodities and technical data with commercial applications, (y) commodities and technical data that may have a dual-use (i.e., may be used in both commercial and military applications), and (z) commodities and technical data that at the time of export from the United States are "inherently military." Additional controls restrict the activities of United States persons abroad in connection with missile, nuclear, or chemical and biological weapons proliferation. Shipments of most United States products and technical data are controlled by the Department of Commerce and the Department of State under two distinct and separate sets of regulations. Other United States Government agencies provide assistance to these departments and exercise authority over certain transactions.

(a) United States Department of Commerce. The Department of Commerce controls shipments of commodities, technical data and software that are used in commercial applications or that have both commercial and military uses. These controls are authorized by the Export Administration Act of 1979. The Department of Commerce administers these controls under the United States Export Administration Regulations.

(b) United States Department of State. The Department of State controls shipments of items which, at the time of export from the United States, are "inherently military" in character. These controls are authorized by the Arms Export Control Act. The Office of Defense Trade Controls ("ODTC") within the State Department administers these controls under the International Traffic in Arms Regulations. Defense manufacturers must register with ODTC and must provide advance notification to ODTC of any planned sale to a foreign party.

(c) Other Agencies. The Department of Defense is also involved in the review of license applications for military items and shipments of dual-use items. The Defense Threat Reduction Agency within the Defense Department is responsible for reviewing Commerce and State Department license applications for sensitive destinations, as well as providing technical assistance on advanced technologies. The Department of Defense does not itself license exports of commercial or military products.

(i) The United States Department of Energy is responsible for the licensing of nuclear materials and for the review of certain Commerce Department applications for dual-use commodities for proposed shipments to countries that are not parties to nuclear non-proliferation treaties.

(ii) The United States Department of the Treasury, Office of Foreign Assets Control, has licensing authority for commercial and financial transactions between United States entities or persons and certain embargoed countries, such as Cuba, Libya, Iraq, Iran, Serbia, Sudan, Afghanistan and North Korea, as well as with specially designated entities worldwide.

(d) Multilateral Organizations.

(i) The Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies began operation in September 1996. The thirty-three (33) participating countries have agreed to exchange information on transfers of conventional arms and dual-use goods and technologies in order to prevent destabilizing accumulations. Participating countries have agreed to maintain effective domestic export controls, implemented in accordance with each country's national legislation, for items on agreed lists. These lists are reviewed periodically to take into account technological developments and experience.

(ii) The Australia Group is an international organization that controls items useful in research, production and testing of chemical and biological weapons. The Australia Group maintains a list of multilaterally controlled chemicals and processing equipment.

(iii) The Missile Technology Control Regime ("MTCR") is an international agreement to control the proliferation of missiles capable of delivering weapons of mass destruction. The MTCR maintains a list of multilaterally controlled equipment and technology useful in missile development and production.

(iv) The Nuclear Suppliers Group ("NSG") is an international organization whose membership includes countries that supply nuclear products and technology. The NSG maintains a list of nuclear technology that is multilaterally controlled to prevent the spread of nuclear weapons. This list is known in the United States as the Nuclear Referral List.

B. Federal Reporting Requirements for Foreign Investors in the United States.

1. International Investment and Trade in Services Survey Act. This Act requires all new foreign investments in United States business enterprises in which a foreign person acquires a 10% or greater voting interest (or the equivalent) to be reported to the Commerce Department's Bureau of Economic Analysis ("BEA"). Foreign persons must file an initial investment report within 45 days of the direct or indirect acquisition, establishment or purchase of the operating assets of a United States business enterprise, including real estate held for other than personal use. An exemption claim may be filed if a newly acquired or established business enterprise has total assets of $3,000,000 or less and owns less than 200 acres of United States land. The Act also requires quarterly and annual reporting, as well as participation in quinquennial (five-year) surveys. The Foreign Direct Investment and International Financial Data Improvements Act of 1990 provides for the exchange of BEA data with the Bureau of the Census, the General Accounting Office, and CFIUS.

(a) Collection and Publication of Information. When a foreign person establishes or acquires a direct investment interest in a United States business enterprise, the BEA collects information on ownership of the investment, its cost, and selected financial data. The following forms are used for this purpose: Form BE-13 (Initial Report on foreign persons direct or indirect establishment or purchase of the operating assets of a U.S. business enterprise, including real estate); Form BE-14 (United States citizens or entities that assist or intervene in a reportable transaction); and Forms BE-605 and BE-605 Bank (data on transactions between United States affiliates and their foreign parent companies); and Forms BE-15 (SF) and BE-15 (LF) (annual survey of foreign direct investment).

(b) Five Year "Benchmark" Surveys.

(i) Every United States business enterprise in which a foreign person owns or controls a direct or indirect interest of 10% or more is required to file reports at the end of each fiscal year that is a benchmark year (i.e., 1997, 2002, etc.).

(ii) Results of the benchmark surveys are presented in the report, Foreign Direct Investment in the United States, published every five years.

(iii) BEA collects information for its benchmark survey on Forms BE-12(X), BE-12(LF), BE-12(SF) and BE-12 Bank.

(c) Confidentiality. To protect reporting firms from exposure of their operations to potential competitors, information collected as part of this process is given confidential treatment and can only be used for analytical or statistical purposes within the United States Government or for purposes of proceedings to penalize lack of compliance with the reporting requirements. Willful violation of confidentiality requirements can result in a penalty of up to $10,000 in addition to any other available remedies.

(d) Failure to File. All BEA reports are mandatory. Failure to file any required form is punishable by a civil penalty of between $2,500 and $25,000 and a restraining order or injunctive relief ordering such person to comply, or both. In addition, criminal penalties, including a fine of not more than $10,000 and imprisonment, can be imposed on the officers, directors, employees or agents of companies that willfully fail to comply.

2. Agricultural Foreign Investment Disclosure Act of 1978.

(a) Any foreign person who acquires or transfers any interest, other than a security interest, in farmland or timberland must submit a report to the Secretary of Agriculture not later than 90 days after the date of the acquisition or transfer.

(b) The Secretary of Agriculture is required to submit bi-annual reports on the data collected to each state Department of Agriculture, or other appropriate state agency.

(c) Reports submitted to the Secretary by foreign persons are available for public inspection at the Department of Agriculture ten (10) days after the report is received by the Secretary.

3. The Domestic and Foreign Investment Improved Disclosures Act of 1977. Any person or other entity which acquires 5% or more of the equity securities of a reporting company under the Federal securities laws must disclose information regarding ownership of the acquiror, including the citizenship and residence of the person reporting as well as the nature of any beneficial ownership of securities.

C. Key Sectors. Key Sectors in which investments or other activities by foreign persons are regulated are:

1. Maritime. Various provisions of the Shipping Act of 1916, the Merchant Marine Act of 1920 and the Merchant Marine Act of 1936 restrict, or have the effect of restricting, foreign investment in the maritime industry.

(a) Restrictions on Foreign Ownership or Control of United States Flag Ships.

(i) A vessel may be documented under the United States flag to engage in foreign trade with the United States provided it is owned by a United States citizen or by a corporation formed in the United States whose chairman and president are United States citizens and whose directors are United States citizens except for no more than the number of directors which would constitute a minority of a quorum.

(ii) Coastwise trade (trade between points in the United States) must be performed by vessels built in the United States and documented under the laws of the United States and owned by United States citizens. A corporation will not qualify as a United States citizen for purposes of the coastwise trade unless, among other things, 75% of the shares of such corporation are owned by United States citizens and the corporation is controlled by United States citizens.

(iii) It is unlawful to sell, mortgage, lease, charter, deliver or transfer a vessel, or control over such vessel, owned in whole or in part by a United States citizen or documented under the laws of the United States to any person not a United States citizen, without the approval of the Secretary of Transportation. The Secretary of Transportation has given blanket approval for all such transactions where the vessel remains documented under the United States flag.

(b) Restrictions on Extensions of Financial Benefits to Foreigners.

(i) The provisions of 46 U.S.C. Section 31301 et seq. (formerly the Ship Mortgage Act of 1920; primarily a recording act) provide that a mortgage covering any United States vessel will have preferred status only if the mortgagee is a State, the United States Government, a citizen of the United States, a Federally insured depositary institution or approved by the Secretary of Transportation.

(ii) Under Title XI of the Merchant Marine Act of 1936, as amended, the Secretary of Transportation provides government-guaranteed financing in connection with the acquisition and construction of United States built vessels for either domestic use or export.

(c) Additional Restrictions.

(i) Whenever the United States furnishes equipment, materials, or commodities for a foreign nation without provision for reimbursement, the appropriate agency must take such steps as are necessary to assure that at least 50% of the gross tonnage of such equipment, materials or commodities to be transported on ocean vessels will be transported on privately-owned commercial vessels under the flag of the United States.

(ii) It is unlawful for any vessel not wholly-owned by a United States citizen to tow any United States vessel other than a vessel in distress from any port or place in the United States, its territories, or possessions.

(iii) In general, no foreign vessel may engage in salvaging operations in the waters off the Atlantic or Pacific Coast of the United States or in other United States waters except when authorized by a treaty.

(iv) A foreign-built dredge may not engage in dredging in the United States unless documented as a vessel of the United States.

2. Aviation.

(a) Restrictions on Foreign Investment in United States Carriers. Under the Federal Aviation Act, foreign investors in United States air carriers may own up to 25% of the voting securities of such a carrier and have the right to nominate up to one-third of the members of the board of directors. In a recent interpretation of this provision, the Department of Transportation authorized a foreign air carrier investor to own up to 49% of the equity (but only 25% of the voting securities) of a United States air carrier. However, care must be taken that actual control of a United States air carrier is vested in United States citizens. Such "control" is a question of fact based on individual circumstances. Congress is considering the possible liberalization of current citizenship requirements. Aviation counsel should be consulted prior to the consummation of a proposed transaction to determine the present status of the citizenship requirements.

(b) Restrictions on Ownership of Aircraft Registered in the United States. No person may operate or navigate any aircraft eligible for United States registration without prior registration. An aircraft is eligible for registration if it is:

(i) owned by a United States citizen or by an individual citizen of a foreign country who is a lawful permanent resident of the United States;

(ii) owned by a corporation lawfully organized and doing business under the laws of any state, so long as the aircraft is based and primarily used in the United States and not registered under the laws of any foreign country; or

(iii) an aircraft of the Federal government or of a state, territory, or possession of the United States or District of Columbia.

(c) Restrictions on Foreign Air Carriers and Foreign Aircraft.

(i) Foreign air carriers must obtain permits or exemption authority from the Department of Transportation in order to engage in foreign air transportation (i.e., between a United States point and a non-United States point). Foreign air carriers may not engage in local United States domestic transportation.

(ii) Foreign aircraft that are not a part of the armed forces of a foreign nation may be navigated in the United States only by airmen holding certificates or licenses issued by the United States or by the nation in which the aircraft is registered if the foreign nation grants a similar privilege concerning United States aircraft.

(iii) Foreign-registered aircraft may be operated by United States carriers in domestic United States transportation under certain "dry lease" (i.e., aircraft without crew) conditions as set forth in the Federal Aviation Administration Regulations.

(d) Additional Restrictions.

(i) A person may not operate an aircraft without an airman certificate. The Secretary of Transportation can prohibit or restrict the issuance of airman certificates to aliens or can make the issuance dependent on the terms of reciprocal agreements entered into with foreign governments.

(ii) The Secretary of Transportation is authorized to provide war risk insurance concerning aircraft operation. Citizenship can be an important factor in obtaining this insurance.

3. Mining.

(a) Under the Mineral Lands Leasing Act of 1920, foreign persons are prohibited from exploring for or extracting mineral deposits on Federal lands unless they intend to become United States citizens or unless they are corporations organized under the laws of any state of the United States.

(b) Also under the Mineral Lands Leasing Act of 1920, leases on government land to explore and develop deposits of coal, phosphate, sodium, potassium oil, oil shale and gas may be obtained only by United States citizens or by domestic corporations. Foreign citizens may own an interest in a domestic corporation that acquires such a lease if the country of which they are citizens accords similar privileges to United States citizens.

(c) Under the Outer-Continental Shelf Lands Act (including pertinent regulations), only United States citizens, resident aliens, or domestic corporations may obtain leases of oil, natural gas, and other mineral deposits in the submerged lands of the Continental Shelf.

(d) Under the Geothermal Steam Act, only United States citizens and domestic corporations may be granted leases for the development and utilization of geothermal steam and associated resources.

4. Energy.

(a) Under the Federal Power Act, licenses for the construction, operation or maintenance of facilities for the development, transmission and utilization of power on land and water over which the Federal government has control may be issued only to United States citizens and domestic corporations.

(b) The Atomic Energy Act of 1954 prohibits any person within the United States from transferring or receiving in interstate commerce, manufacturing, producing, acquiring, possessing, using, importing or exporting any nuclear utilization or production facility except under a license. A license for nuclear facilities cannot be obtained by a foreign citizen or by a corporation believed to be controlled by a foreign citizen or government.

5. Real Estate.

(a) The taxation of dispositions of real property interests by foreign investors is governed by the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"). Additional regulations relate to disclosure of real estate investments by foreign persons or entities (the Agricultural Foreign Investment Disclosure Act of 1978), reclamation of real estate (the Desert Land Act), and grazing rights (the Taylor Grazing Act).

(b) Under FIRPTA, the gain derived by foreign investors from the disposition of "United States real property interests" is subject to United States income tax at regular United States income tax rates. Dispositions may include sales, like-kind exchanges, transfers of an interest in a partnership, trust or estate, corporate reorganizations, mergers or liquidations. United States real property interests include direct interests in real property (including an interest in a mine, well, or other natural deposit) located in the United States (other than an interest solely held as a creditor), as well as interests in corporations organized in the United States of which a substantial portion of the fair market value of the assets consist of United States real property interests held for prescribed periods of time, and interests in partnerships, trusts or estates to the extent of the United States real property interests owned by the partnerships trusts or estates. In order to enforce the tax, the law requires that any purchaser or other transferee of a United States real property interest must, unless an exemption applies, withhold and pay over to the IRS a portion of the amount realized on the disposition as an advance payment of any tax due. Any amount so withheld is creditable against the foreign transferor's actual tax liability. There are certain exceptions to FIRPTA; notably, the disposition of a personal residence for $300,000 or less, and certain dispositions of stock of publicly traded corporations.

6. Banking. Foreign banks may conduct banking activities in the United States either through branches or agencies, commercial lending company subsidiaries, Edge Act subsidiaries or domestic bank subsidiaries. The establishment of a branch or agency, which may be licensed by either Federal or state authorities, or the establishment or the acquisition of ownership or control of a commercial lending company subsidiary, requires the prior approval of the Board under the International Banking Act and the Board's implementing regulations. Such an establishment will subject a parent bank to the provisions of the International Banking Act of 1978, as amended, and the Bank Holding Company Act of 1956, as amended. Edge Act subsidiaries, which are authorized only to engage in international activities, may be established or acquired with the approval of the Board, as may domestic bank subsidiaries.

Federal law does not restrict foreign ownership of domestic banks, which may be Federally-chartered or state-chartered. However, all companies owning such banks are subject to the provisions of the Bank Holding Company Act, which restricts bank holding companies from engaging in non-banking activities that are not deemed to be closely related to banking. However, this Act contemplates a limited amount of flexibility with respect to the conduct of non-banking activities in the United States by foreign banking organizations that are principally engaged in the banking business outside of the United States ("qualifying foreign banking organizations"), such as in the case of investment in foreign companies that are principally engaged in business activities outside the United States and whose United States activities are only incidental to their international or foreign business. In addition, foreign banks meeting the applicable criteria may become financial holding companies, which would significantly expand the nature of activities in which United States affiliates may engage. See XVIII.B.3 below. Qualifying foreign banking organizations are also generally permitted to engage directly or indirectly in activities of any kind outside the United States without regard to the restrictions of the Bank Holding Company Act. The law of the chartering authority of a domestic bank subsidiary may contain restrictions on matters of concern to a foreign business organization, such as citizenship or residency requirements for members of a bank's board of directors.

7. Government Contracting. Both United States and foreign corporations that are controlled or owned by foreigners can conduct business with the Federal government on generally the same basis as United States owned corporations. However, some Federal statutes require Federal agencies to give preference to products produced in the United States. Many state governments have similar provisions.

(a) Buy American Act.

(i) The Buy American Act requires the purchase of United States produced goods for public use unless the head of a department or agency determines that the purchase is inconsistent with the public interest or the cost is unreasonable. Regulations implementing this law apply price differentials in favor of domestic sources.

(ii) Under the Trade Agreements Act of 1979, the President has waived application of the Buy American Act requirements with respect to purchases of articles from nations that are parties to the GATT Government Procurement Agreement. However, this waiver does not apply to all products and agencies.

(iii) A revised Agreement on Government Procurement will come into force as of January 1, 1996. This agreement applies to a wider range of articles and agencies and includes for the first time some construction materials and services. It also applies to some state government procurement.

(iv) The North American Free Trade Agreement ("NAFTA") also exempts products of Mexico and Canada from many Buy American Act requirements, as does a free trade agreement with Israel.

(v) The Caribbean Basin Initiative provides treatment similar to the Trade Agreements Act to products originating in participating Caribbean region nations. Tariff exemptions are also granted under this program.

(vi) "Little Buy American Acts" have also been enacted which set purchase limitations on certain products or require certain materials to be of domestic origin.

(b) Defense Contracts. Foreign ownership of firms performing defense contracts is generally permitted, although citizenship requirements may apply to government contracts in certain areas, such as aircraft parts and aeronautical accessories, in certain circumstances. Restrictions apply to the performance of classified contracts by firms that are subject to foreign ownership control or influence ("FOCI").

(i) The Department of Defense's Industrial Security Program regulates foreign owned, controlled, or influenced facilities that hold government contracts for classified work. These facilities are not eligible for government contracts if foreign dominance over the management or operations of the facility could result in the compromise of classified information or have any adverse impact upon the performance of classified contracts.

(ii) The Department of Defense requires that certain arrangements be made to retain a security clearance when a foreign interest's stockholdings are large enough so that the foreign interest has effective control or has the dominant influence over the business management of the United States firm.

(iii) The most common arrangement is a voting trust arrangement whereby the stockholder transfers legal title of the stock to three trustees whom the stockholder selects, subject to Department of Defense approval. The stockholder retains a beneficial interest in the stock, including the right to receive dividends and distributions. The Department of Defense requires that the trustees be United States citizens residing in the United States, that they be disinterested individuals with no prior involvement with either the facility or the foreign interest, and that they be eligible for and receive personal security clearances at the level of the facility's clearance. The chairman of the board of directors and a sufficient number of directors must also receive security clearances. The foreign interest cannot be represented on the board of directors. Subject to certain exceptions, the voting trust arrangement must unequivocally permit the trustees to exercise the prerogatives of ownership independently without consultation with, interference by, or influence from the foreign stockholders.

(iv) Another type of arrangement is an irrevocable proxy agreement in which the power to vote the shares is given to certain individuals while the legal ownership remains with the foreign interest.

(v) Either of the above arrangements is supplemented by a Visitation Approval Procedure Agreement. Subject to certain exceptions, such an agreement requires prior approval from the trustees or the proxy holder for visits to the facilities, and visits between personnel of the United States company and of the foreign stockholder at other locations.

(vi) A third arrangement is available when the United States has entered into a Reciprocal Industrial Security Agreement with the government of the foreign interest. On being advised of a proposed or actual acquisition, the United States Government will seek a "security assurance" regarding the acquiring firm from the foreign government. The foreign government will follow its own procedures and apply its own standards in giving such assurances which will be accepted by the United States Government unless it has independently determined that the granting of clearance is inadvisable.

(vii) The Department of Defense has indicated that, in extraordinary circumstances, it will permit an individually tailored security arrangement to be made which does not require the establishment of a voting trust or proxy arrangement, or which goes beyond those permitted under a Reciprocal Industrial Security Agreement.

(c) Other Requirements. Federal statute prohibits the assignment of Federal government contracts and claims and requires novations (i.e., agreements in which a Federal agency indicates that it is willing to recognize a successor in interest to the contract) to meet certain conditions when a party (foreign or domestic) acquires the assets of a company used in the performance of government contracts, or when, as a result of a stock acquisition, merger or reorganization, a new corporate entity is designated to perform the contracts.

8. Financial Services.

(a) The 1940 Act requires registration with the SEC of any investment company doing business in the United States. Only domestic investment companies may, as a practical matter, engage in public offerings, although the SEC retains discretion to extend such right to foreign issuers under special circumstances.

(b) The Trust Indenture Act of 1939 prohibits the sale in interstate commerce of certain securities that have not been registered under the 1933 Act unless the securities have been issued under an indenture. Congress enacted the Trust Indenture Reform Act of 1990, which modernized the 1939 Act. Among other changes, the Reform Act permits non-United States banks to act as sole trustee under certain circumstances. In addition, the Reform Act grants the SEC general exemption authority. Under prior law, the SEC could grant exemptions only for certain securities issued by non-United States persons.

(c) Securities issued by foreign issuers are eligible for listing on the national stock exchanges and for quotation on Nasdaq. The SEC has adopted Rule 144A, which facilitates trading of certain unregistered securities among institutional investors. This rule is available to foreign issuers. The SEC also has adopted rules for a multi-jurisdictional disclosure system to simplify the offering of Canadian securities in the United States.

(d) Investment Advisers Act of 1940 ("Advisers Act"). The SEC's Division of Investment Management (the "Division") has relaxed regulatory requirements affecting a foreign investment adviser and its foreign parent. Under prior law, a foreign adviser could avoid registration as an investment adviser under the Advisers Act only if it took extensive steps to insulate itself from an advisory affiliate registered in the United States. Under a 1992 "no-action" letter, the Division indicated that a foreign registered adviser need not adhere to the substantive provisions of the Advisers Act with respect to its non-United States clients, and need not have as great a degree of separation from its foreign parent as previously required. While the Division imposed several important conditions on such arrangements, the new guidelines should simplify the ability of advisory affiliates of foreign entities to operate in the United States. <u>UNIBANCO Uniao de Bancos de Brasileiros S.A</u>. SEC. No-Action Letter [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) 76,425 (July 28, 1992).

(e) A custom house broker must be a United States citizen to be licensed.

D. <u>State Regulation of Foreign Investment in the United States.</u>

1. <u>Alien Land Laws</u>. A number of states have laws regulating land investments by alien investors. These statutes impose a wide variety of limitations and reporting requirements. There are several Federal treaties regulating land ownership, however, which preempt contrary state laws.

2. <u>Natural Resource Investments</u>. Several states regulate mining activities conducted by aliens.

3. <u>Banking</u>. Several state codes contain specific provisions dealing with activities of foreign banks within their jurisdictions:

(a) A foreign bank may choose to operate a branch or agency in the United States under state license instead of a Federal license;

(b) State law determines whether a foreign bank may establish a representative office;

(c) A state has the right under the International Banking Act of 1978 to prohibit foreign banks from establishing operations within its jurisdiction; and

(d) State law may contain provisions regarding the ownership of state-chartered banks by foreign institutions, including citizenship and residency requirements for directors and senior executive officers.

XVIII. <u>REGULATED INDUSTRIES.</u>

A. <u>Electric and Gas Utilities.</u> The acquisition of an electric or gas utility will frequently face both Federal and state regulatory hurdles.

1. Federal Regulation.

(a) Public Utility Holding Company Act of 1935.

(i) Overview of 1935 Act. The Public Utility Holding Company Act of 1935 ("1935 Act") pervasively regulates the activities of those public utility holding company systems that are subject to its jurisdiction. The SEC administers the 1935 Act and is authorized to regulate such matters as securities issuances and acquisitions. Regulation under the 1935 Act reaches not only operating utilities but also their non-utility affiliates. For this and other reasons, it is generally considered important to structure a utility acquisition so as to avoid registration as a public utility holding company under the 1935 Act. Under the 1935 Act, a holding company is any "company" which owns, controls or holds with power to vote 10% or more of the voting securities of an electric utility or a gas distribution utility. A "company" can be a company, a partnership, a trust or an "organized group of persons."

(ii) Exemptions from the 1935 Act. 1935 Act jurisdiction does not extend to operating utilities that do not have a holding company. The 1935 Act includes exemptions from the registration provisions of the 1935 Act for certain holding companies. Only three of these exemptions are generally relevant to structuring an acquisition, the intrastate exemption (i.e., where the holding company and all material utility subsidiaries are organized under the laws of a single state in which each of the utility subsidiaries does the predominant part of its business), the exemption for a holding company that is incidentally a holding company (i.e., the non-utility parent is substantially larger than the utility subsidiary) and a holding company which is predominantly a public utility company which operates only in its state of incorporation and states contiguous thereto.

(iii) Possible Repeal or Amendment of the 1935 Act. For over a decade, there has been and continues to be substantial activity by the SEC and others which could, in the near future as early as the Fall of 2003, result in the repeal of the 1935 Act or the amendment thereof, in such a way as to reduce materially the Act's restrictions.

(b) The Federal Power Act.

(i) The Federal Power Act (the "FPA") requires approval by the Federal Energy Regulatory Commission ("FERC") for an acquisition of an electric utility whether a sale or merger.

(ii) In 1987, on the basis of its jurisdiction under the FPA over the transfer of electric utility assets (including transfer pursuant to mergers), FERC asserted jurisdiction over transactions involving the formation of a holding company to own an existing utility (essentially a corporate reorganization and the acquisition by a registered holding company of the stock of an additional electric utility). In addition, FERC has decided to exercise jurisdiction over the merger of two utility holding companies in virtually all circumstances (even if it is not proposed to merge the utility subsidiaries). Each of these positions represents a new policy of FERC and reverses prior precedents. It should be expected that FERC will continue to treat these transactions as jurisdictional.

(iii) Because FERC treats entities which market power as public utilities and treats intangible assets, such as contracts and books and records, as jurisdictional assets, the transfer or sale of which requires FERC approval, FERC has asserted jurisdiction over parts of larger transactions which may appear to be only peripherally related to utilities.

(c) Energy Policy Act of 1992.

(i) Signed into law on October 24, 1992, the Energy Policy Act of 1992 ("1992 Act") includes important revisions to the 1935 Act and the FPA.

(ii) The 1992 Act permits a person exclusively in the business of owning and/or operating "eligible facilities" and selling electricity at wholesale to apply to FERC for designation as an Exempt Wholesale Generator ("EWG"). EWGs are exempt from the provisions of the 1935 Act, and both exempt holding companies and registered holding companies may own EWGs. Previously, developers of merchant, non-utility wholesale power generators had to adopt complicated and inefficient ownership structures in order to avoid pervasive regulation as holding companies.

(iii) The 1992 Act amends the FPA to permit any person generating electric energy for sale for resale to apply to FERC for an order requiring a transmitting utility to "wheel" that energy (i.e., to provide transmission services). In 1997, FERC required jurisdictional transmitting utilities to file a standard open access transmission tariff, hoping to expedite the provision of transmission service.

(iv) The 1992 Act creates a new exemption from the 1935 Act for a "foreign utility company," thereby enabling both exempt and registered holding companies, subject to certain restrictions, to invest in or acquire one or more foreign utility companies.

(d) Atomic Energy Act of 1954.

The Atomic Energy Act of 1954 (the "AEA") strictly regulates the development, use and control of atomic energy. The Nuclear Regulatory Commission (the "NRC") administers the AEA. Companies that operate a nuclear generating facility are required to be licensed under the AEA by the NRC. The transfer or disposition of an NRC operating license requires the consent of the NRC and an NRC finding that the transfer or disposition is in accordance with the AEA.

2. State Regulation. Virtually every state regulates the activities of electric and gas utilities that operate within its boundaries, generally through a public utility commission or some similar entity. Many states explicitly authorize their public utility commissions to regulate a change of control of a utility. Even in states without explicit statutory authorizations, however, public utility commissions may deem a change of control of a utility to be within their inherent power and thereby assert jurisdiction.

B. Insurance Companies.

1. Acquisitions of Insurance Companies.

(a) Most state laws prohibit changes in control of domestic insurance companies, and in some cases non-domestic insurance companies doing business within such states, without the prior approval of the insurance commissioner.

(b) "Control" varies by state but generally entails ownership of a specified percentage of stock.

(c) Approval usually requires the filing of a detailed statement (Form A) concerning the business, management and significant stockholders of the acquiring entity.

(d) Effect on existing policies:

(i) An insurance company which takes over the assets of another insurance company may become liable for the obligations of the company, the assets of which it has acquired, even in the absence of any agreement or provision as to the assumption of obligations.

(ii) An insurance company cannot without the consent of its policyholders transfer its entire business and assets to another company. Where such a transfer is made without policyholder consent, a policyholder may elect to repudiate the transfer and rely on the original liability or affirm the transfer and rely on the liability of the transferee company.

2. Acquisitions by Insurance Companies.

(a) Many state laws regulate the types of businesses an insurance company may own.

(b) State laws often restrict the ownership by an insurance company of an investment in excess of a specified percentage of an issuer's stock.

C. Banks, Savings Associations, and Holding Companies.

1. Introduction.

(a) In our dual banking system, there are specific state and Federal laws and regulations applicable to acquisitions of state and federally chartered institutions. The Bank Merger Act ("BMA") and the Change in Bank Control Act ("CBCA") apply to all insured depository institutions. Additionally, each federal bank regulatory agency has provisions in its enabling act as well as implementing regulations that govern combinations.

(i) National banks are regulated by the Office of the Comptroller of the Currency ("OCC").

(ii) Each state charters and regulates state banks.

(iii) State banks that are member banks are also regulated by the Federal Reserve Board ("Board"). The Board also regulates combinations of bank holding companies and financial holding companies.

(iv) Insured nonmember state banks are also regulated by the Federal Deposit Insurance Corporation ("FDIC").

(v) Savings associations or savings banks (also referred to as "thrifts" and "savings and loans") can be federally or state chartered. All savings associations and savings and loan holding companies are regulated by the Office of Thrift Supervision ("OTS"). State chartered savings associations are also subject to state regulation.

(b) Traditionally, United States law generally mandated the separation of banking from other commercial and industrial pursuits, and the universe of permissible acquirors of banks and bank holding companies was quite limited and consisted mainly of United States banks and bank holding companies, foreign banking organizations and individuals.

(c) In 1999, Congress liberalized those limitations and provided for the establishment of financial holding companies which could own both banks and companies engaged in activities of a financial nature and to make certain investments in companies without regard to the nature of their business.

(d) Interstate acquisitions are much more easily accomplished today than in the past, but acquirors need to be aware of possible state restrictions against de novo branching and age requirements.

(e) The regulatory impact of state law varies by state (and is thus not discussed here) and must also be considered in planning a bank acquisition.

(f) Each federal and state banking agency requires prior approval for all combinations where the resulting institution is subject to its jurisdiction. Where the institution to be acquired is subject to its jurisdiction but the resulting institution is not, approval is not necessary, but notice must be provided.

2. The Bank Holding Company Act of 1956.

(a) The Bank Holding Company Act (the "BHCA") requires the prior approval of the Board for any acquisition of control of a United States bank or bank holding company by a company that, by virtue of such acquisition, becomes a bank holding company. Additionally, where the acquiror is already a bank holding company or a foreign bank with a United States branch or agency or a United States commercial lending company subsidiary, the BHCA requires prior Board approval for any acquisition that results in the acquiror controlling more than 5% of any class of voting securities of a United States bank or bank holding company.

(b) The term "company" is defined by the BHCA to include corporations, partnerships and business trusts. A company is deemed to have "control" over a bank or bank holding company (and thereby to be a bank holding company) if (x) the company directly or indirectly (or acting through one or more persons) owns, controls or has power to vote 25% or more of any class of voting securities of the bank or bank holding company; (y) the company controls in any manner the election of a majority of the directors of the bank or bank holding company; or (z) the Board determines, after notice and opportunity for a hearing, that the company directly or indirectly has the power to exercise a controlling influence over the management or policies of the bank or bank holding company. There is, however, a presumption of non-control where any company owns or has the power to vote less than 5% of any class of voting securities of a bank or a bank holding company.

(c) The Interstate Banking and Branching Efficiency Act (the "Interstate Banking Act"), created a uniform system of interstate banking in the United States. Under the Interstate Banking Act, adequately capitalized and adequately managed bank holding companies may acquire control of a bank in any state, without regard to whether such transaction is prohibited under state law. This authorization is available to a foreign bank wishing to acquire a U.S. bank located outside its "home state," typically, the state in which the foreign bank's principal U.S. banking office or principal U.S. bank subsidiary is located. States may impose certain limitations on such acquisitions by domestic or foreign banks or bank holding companies, however, such as minimum age requirements for target banks and deposit concentration limits, and certain other statutory limitations also apply.

(d) To obtain the Board's approval, the acquiror must submit a formal application containing extensive information concerning the acquiring institution. Capital adequacy is always of primary concern to Federal regulators. The BHCA provides that the Board may not approve an acquisition, the effect of which may be substantially to lessen competition, unless it finds that the public benefits of the transaction would outweigh its anti-competitive effects. The Board is also required to take into consideration the convenience and needs of the community to be served, and in recent years its principal focus in this area has been the record of performance of the acquiror's U.S. subsidiary banks and the target bank or banks under the Federal Community Reinvestment Act, which requires banks to help meet the credit needs of the communities in which they are located. The Board may not approve an application where the applicant fails to provide the Board with adequate assurances that it will make available to the Board such information on the operations or activities of the applicant and any affiliate as the Board determines to be appropriate for purposes of enforcing compliance with the BHCA.

In addition, where the applicant is a foreign bank or bank holding company, the Board may not approve an application where the applicant is not subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country. The Board's processing timetable for applications by foreign banks or bank holding companies is typically longer than that for applications by domestic bank holding companies, due to the need to conduct background checks in the foreign country.

(e) Both foreign and domestically-organized bank holding companies are required to report to the Board on a periodic (annually and quarterly) and an event-generated basis concerning their financial condition, activities and investments.

3. <u>Financial Holding Companies</u>

(a) The Gramm-Leach-Bliley Act enacted in 1999, permitted the establishment of financial holding companies which could engage in both banking as well as other activities of a financial nature, possible through a holding company structure to engage not only in nonbanking activities previously permitted to bank holding companies, but also in any other activity of a financial nature. Thus, banks, insurance companies and investment banks could be under the same holding company structure. Financial holding companies could also, through insurance and broker-dealer subsidiaries, engage in merchant banking, which would permit it to make equity investments in nonfinancial companies (on a nonoperating basis) without limitation as to the nature of the activities conducted by the company in which the investment is made.

(b) A financial holding company is essentially a bank holding company that meets certain criteria and files a declaration with the Federal Reserve. The applicable criteria require that all depositary institutions controlled by the declarant be well capitalized (generally, a minimum of 6% tier 1 capital and 10% total capital) and be well managed. Foreign banks must also satisfy the Board that they are subject to a comprehensive system of consolidated supervision by its home country regulators.

(c) Financial holding companies may establish or acquire subsidiaries engaged in financial activities without the prior approval of the Board by filing a post fact notice.

(d) If a financial holding company, once established, fails to meet these criteria, it must either return to compliance within a specified period of time or divest those subsidiaries not permissible to a bank holding company.

4. Change in Bank Control Act.

(a) The Change in Bank Control Act ("CBCA"), adopted by Congress in 1978, extends the requirements for regulatory approval to acquisitions of control of banks by individuals, as well as acquisitions by corporations and other legal entities of voting securities of banks in amounts below the control threshold in the BHCA. Transactions subject to the BMA are exempt from the CBCA; acquisitions by "persons" which are not bank or financial holding companies would be covered. Each federal banking agency issues its own implementing regulations, which, for example, define "persons" slightly differently. However, the agencies have adopted a uniform "Interagency Notice of Change in Control" and an "Interagency Biographical and Financial Report," which must be submitted for each person named in the notice.

(b) For purposes of the CBCA, control is defined to mean "the power, directly or indirectly, to direct the management or policies of an insured depository institution or to vote 25 percent or more of any class of voting securities of an insured depository institution."

In addition, the implementing regulations of the Federal banking agencies provide that there is a rebuttable presumption of control where there is an acquisition of 10% or more (but less than 25%) of any class of voting securities of the target institution and (A) the target institution's shares are registered under Section 12 of the 1934 Act, or (B) no other person will own a greater percentage of that class of voting securities immediately after the transaction.

(c) Transactions meeting either threshold indicated above are subject to the requirement that a notice be filed with the appropriate Federal banking agency 60 days prior to the acquisition of control of the shares of the target institution. The form of notice requires information concerning the identity, personal history, business background and financial condition of each person by whom or on whose behalf the proposed acquisition is to be made.

5. The Bank Merger Act.

(a) Under the Bank Merger Act, no institution whose deposits are insured by the FDIC may, without specified prior approvals:

(i) merge or consolidate with any other depository institution;

(ii) assume the deposits or other liabilities of such institution;

(iii) transfer assets to any uninsured institution in consideration of the assumption of any portion of the deposit liabilities of the insured bank; or

(iv) acquire the assets of an insured depository institution.

(b) Regulatory Agency. If the acquiring, assuming or resulting bank is to be a national bank, approval of the Comptroller of the Currency must be sought; if it is to be a state bank which is a member of the Federal Reserve System, the Board is the approving agency; and if it is to be a state bank which is not a member of the Federal Reserve System, the FDIC is the approving agency. The federal agencies have adopted a uniform "Interagency Bank Merger Act Application."

(c) The BMA prohibits any merger transaction which would result in a monopoly or substantially lessen competition unless the federal bank regulatory agency finds that the anti-competitive effects are outweighed by the public interest. The agency must request reports from the Attorney General and the views of the other agencies, and the date of consummation is extended by 30 days from the date of approval in order to allow ample time for the Attorney General to act. This provision dovetails with the exemption in the Hart-Scott-Rodino Act for transactions that require agency approval.

(d) The Interstate Banking Act also amended existing Federal law to permit a U.S. bank to merge with another bank across state lines. The Interstate Banking Act also provides foreign banks engaged in banking in the United States through existing branches or agencies with the same general rights to branch on an interstate basis through merger transactions. This legislation marks the first time that interstate bank branching has generally been permitted in the United States, as interstate bank mergers by domestic or foreign banks have previously been generally prohibited under Federal and state laws.

(e) Unlike the case of interstate bank acquisitions described above, however, under the Interstate Banking Act, a state could choose to "opt out" of the interstate merger/branching scheme. Only Missouri and Minnesota opted out. Such legislation must apply on a non-discriminatory basis to all out-of-state banks, wherever located. Certain limitations on interstate merger transactions, such as concentration limits, are imposed by the Interstate Banking Act, and the states may also impose limitations of their own, such as minimum age requirements for target banks.

6. The International Banking Act.

(a) Under the International Banking Act of 1978, as amended by the Foreign Bank Supervision Enhancement Act of 1991, a foreign bank is required to obtain the approval of the Board before it may, inter alia, establish a branch, agency or representative office or establish or acquire a commercial lending company subsidiary in the United States. This statutory provision imposes a regulatory application requirement upon merger and acquisition transactions involving foreign banks with United States banking offices.

(b) The Board's regulations generally require a foreign bank seeking to establish a United States banking office to file a formal application with the Board for its approval prior to establishing the office. However, where the United States banking office is to be established through an acquisition of, or merger or consolidation with, another foreign bank having a United States banking office, the Board may in its discretion allow the transaction to proceed before an application to establish the office has been filed and approved, provided that:

(i) the foreign bank or banks resulting from the acquisition, merger or consolidation will not directly or indirectly own or control more than 5% of any class of voting securities of, or control, a United States bank;

(ii) the Board is given reasonable advance notice of the proposed transaction;

(iii) prior to consummation of the transaction, each of the foreign banks involved either have already complied with the application procedures in the Board's regulations or have committed in writing to comply with them within a reasonable period of time, and have also committed not to engage in any new lines of business or otherwise to expand United States activities until the disposition of the application by the Board; and

(iv) each of the foreign banks involved commits in writing to abide by the Board's decision on the application, including, if necessary, a decision to terminate the activities of any United States office as the Board may require.

(c) The Board's implementing regulations include within the definition of the term "establish":

(i) acquiring directly, through merger, consolidation, or similar transaction with another foreign bank, the operations of an office that is open and conducting business; and

(ii) acquiring an office through the acquisition of a foreign bank subsidiary that will cease to operate in the same corporate form following the acquisition.

(d) The factors considered by the Board in reviewing an application by a foreign bank to establish a United States banking office include, inter alia, whether the foreign bank is engaged directly in the business of banking outside the United States, whether it is subject to comprehensive supervision or regulation on a consolidated basis by its home country supervisor, and whether it has furnished the Board with adequate information in connection with the application as well as adequate assurances that information regarding the activities and operations of the bank and its affiliates will be provided to the Board on an ongoing basis.

(e) In addition to the application requirement for the establishment of a United States banking office, the Board's regulations require a foreign bank with an existing United States banking office to notify the Board in writing within 10 days of, inter alia, an acquisition or change of control of the foreign bank where the acquiror or investor is another foreign bank or company and where the acquired foreign bank continues to operate in the same corporate form as prior to the change in ownership or control.

(f) Foreign banks with United States bank subsidiaries or branches or agencies in the United States may, if they meet the applicable well-capitalized and well managed criteria, become financial holding companies with the same authority to acquire companies engaged in financial activities and to engage in merchant banking as domestic financial holding companies.

D. Airlines and Other Transportation Carriers. The Department of Transportation's authority with respect to air carrier mergers or acquisitions expired on December 31, 1988. All airline mergers or acquisitions must now be reported to the DOJ and the FTC in accordance with the requirements of the HSR Act. The Interstate Commerce Commission, however, retains its authority with respect to the consideration and approval of mergers and acquisitions involving surface carriers.

E. Television, Radio and Other Communications Properties – Federal Communications Commission. All interstate and foreign communication by wire or radio is regulated by the FCC. Any transfer of control of an FCC license (by assignment, sale or change in control of the owner) must be approved by the FCC. Final FCC approval normally will take at least 90 days from the filing of an application to transfer a license with the FCC, and may take considerably longer in complex transactions or if challenged by a third party or if objections are raised by the FCC when the transfer is filed. Broadcast station acquisitions may be limited to restrict overlap in the areas of reception of the stations, the number of stations owned by any single owner, and the presence of cross-media interests (e.g., newspapers and broadcasting) in the same local markets, as well as by general considerations of the prospective licensee's character. Depending on the entity, foreign investment in broadcast, common carrier, aeronautical en route or aeronautical fixed radio station licenses may be prohibited entirely, or may be permitted to reflect a 25 percent equity stake in a U.S. company holding one or more of these licenses.

XIX. OTHER CONSIDERATIONS.

A. Pension and Other Employee Benefit Plans.

1. Pension Plans. Generally, where the target has a pension plan for its employees, an acquiror in an asset transaction should determine whether to assume the plan. (This may also be true in certain stock acquisitions.) An acquiror that assumes a plan may (a) continue the plan, (b) freeze benefits under the

plan, (c) merge the plan into an existing pension plan of the acquiror, or (d) terminate the plan. Regardless of whether or not the target has a pension plan for its employees, the acquiror in a stock acquisition may be liable for excise taxes or subject to a lien on its assets and the target's assets if a pension plan for employees of other members of the target's controlled group have not met the minimum funding standards under the Internal Revenue Code of 1986, as amended (the "Code") or have failed to make certain required contributions to an underfunded pension plan.

(a) Where the pension plan is assumed and continued by the acquiror:

(i) purchase accounting may require acquiror to recognize a liability on its balance sheet for the assumed plan's unfunded pension liabilities; in addition, further accruals will be a charge against future earnings;

(ii) it will be necessary to obtain an independent actuarial valuation of plan assets and liabilities (e.g.., most recent plan actuarial report, most recently filed Treasury Form 5500 and Schedule B, independent actuarial review of assumptions and projections); and, to the extent that the plan is over-funded or under-funded, a purchase price adjustment may be appropriate (a downward purchase price adjustment may be warranted even if the assets are equal to or exceed the liabilities if the purchaser's annual cost of maintaining the plan will be greater than that of the seller);

(iii) minimum quarterly contributions must be made to an assumed plan; a statutory lien in favor of the plan against the assets of the sponsor and its controlled group may result where a payment is missed and the unpaid balance of the payment and all prior missed payments exceed $1,000,000; missed payments to any plan may require notice to employees and may result in the assessment of an excise tax equal to 10% of the unpaid balance of the minimum contribution;

(iv) the extent of ongoing liability depends on actuarial assumptions applied as well as plan investment performance and employee retirement and mortality experience;

(v) the status of any plan as "top-heavy" may require certain minimum benefit accruals for non-key employees in order to maintain the qualification and tax-exempt status of the plan;

(vi) where the plan also covers employees of a business not acquired, it will be necessary to obtain an actuarial valuation of plan assets and liabilities to be spun-off and assumed by the acquiror;

(vii) assumption of the plan and the acquisition itself may be "reportable events" requiring notice to the Pension Benefit Guaranty Corporation ("PBGC") within 30 days following the acquisition (in the case of certain significantly underfunded plans, such notice is required no later than thirty days prior to the acquisition);

(viii) generally, an assumed pension plan must cover the lesser of 50 employees or 40% of all employees of the controlled group by the first day of the second plan year beginning after the date of acquisition; and

(ix) Issues relating to plans covering employees in separate lines of business should be addressed.

(b) Where the pension plan is assumed but benefits are frozen:

(i) at least 15 days' advance notice must be given to participants before freezing the plan (in some cases 45 days' advance notice may be required); and

(ii) it is possible that the annual cost of the plan may be reduced.

(c) Where the plan is merged with the existing pension plan of the acquiror:

(i) the acquiror must comply with Section 414(l) of the Code and regulations that require each employee's funded pension benefit after the plan of merger to be no less than his or her funded pension benefit immediately prior to the plan of merger;

(ii) notice must be given to the IRS on Treasury Form 5310-A at least 30 days before the merger is effected and include required actuarial certifications;

(iii) if the plan of the target has a funding deficit or surplus, the merger may increase or reduce the annual cost of the surviving plan;

(iv) if the continuing benefit formula is less than target plan's benefit formula 15 days' advance notice must be given to all participants (45 days' advance notice may be required in some cases); and

(v) the merger of the plans may be a reportable event requiring notice to the PBGC within 30 days following the acquisition (in the case of certain significantly underfunded plans, 30 days' prior notice is required).

(d) Where the pension plan is terminated:

(i) an underfunded plan may be voluntarily terminated only if the plan sponsor and each member of the controlled group are in extreme financial distress and will not be able to continue in business unless the plan is terminated;

(ii) if plan assets are insufficient to pay "benefit commitments," the plan sponsor and members of the controlled group are liable to the PBGC for the total amount of "unfunded benefit liabilities" to all plan participants; this liability may be subject to a PBGC lien (with the priority of a Federal tax lien) against up to 30% of the positive net worth of the controlled group;

(iii) if plan assets are insufficient to pay benefits guaranteed by the PBGC, immediate liability of the plan sponsor and the controlled group to the PBGC may result;

(iv) if the termination results from an acquisition by way of merger or consolidation, there may be PBGC liability where plan assets of any Seller's pension plan are insufficient to pay benefits guaranteed by PBGC and such plan is terminated prior to the acquisition;

(v) the target may be liable upon the termination of a former controlled group plan transferred out of such controlled group at a time when the target was a member of such controlled group if the purpose of the sale was to evade PBGC liability;

(vi) if the acquisition was solely an acquisition of assets, the acquiror may avoid PBGC liability by not assuming the plan;

(vii) if plan assets exceed the amount necessary to pay all plan benefits, the plan may be terminated and the excess may be returned to the employer if the plan so provides. A reversion of excess assets from the termination of an overfunded plan will be subject to income tax and a special 50% excise tax (or a 20% excise tax if the employer establishes a qualified replacement plan or amends the terminating plan to provide for benefit increases);

(viii) notice to the PBGC and participants at least 60 days prior to termination of the plan is required;

(ix) if there is only partial termination of the plan (i.e., part of the plan continues for other employees), generally no PBGC liability will result (although vesting of benefits under the plan may be required); and

(x) an IRS determination letter should be sought in any transaction involving a plan termination.

2. Profit-Sharing Plans and Employee Stock Ownership Plans.

(a) An acquiror assuming a profit-sharing plan or similar individual account plan may continue the plan, discontinue contributions to the plan, merge the plan into an existing profit-sharing plan of the acquiror or terminate the plan. Profit-sharing plans and similar individual account plans are not subject to PBGC regulation and therefore involve no PBGC liability or reporting requirements.

(b) ESOPs', profit-sharing plans and other plans holding employer securities present special issues:

(i) if a stock acquisition, the plan should receive the same consideration for stock as other stockholders (see XIX.A.7.(a)(i);

(ii) if a stock acquisition, 1934 Act Section 16(b) issues may need to be addressed;

(iii) if employees contribute to the plan, 1933 Act registration issues may need to be addressed (Form S-8);

(iv) if the plan is a leveraged ESOP, loan instruments should be examined; loan repayment should be considered; the loan may require continuing employer contributions to avoid default; loan default may result in problems with other lenders of the target; and

(v) if the plan holds stock of the former parent corporation, compliance with ERISA diversification requirements may require liquidation of this asset and an examination of "qualifying employer stock" issues should be made.

(c) If the plan is "top-heavy," certain minimum contributions may have to be made on behalf of non-key employees in order to maintain the plan's tax qualified status.

(d) If the profit-sharing plan is a cash or deferred arrangement, the qualification of the plan after the acquisition may be at issue due to a special non-discrimination test for such an arrangement.

(e) ESOPs are often used as anti-takeover devices, although certain legal issues in connection with such use have not been definitively resolved by the courts and regulatory agencies:

(i) The ESOP trustee typically follows participant instructions in voting and tendering shares of employer securities allocated to the ESOP participants of the individual accounts.

(ii) If plan is a leveraged ESOP, it may hold a large block of unallocated shares. Many ESOP trust agreements provide for a "mirror" or "pass-through" voting arrangement authorizing the trustee to vote and tender the unallocated shares in the same proportion as participants vote and tender their allocated shares. However, a trustee will be relieved of its fiduciary obligations to participants with respect to the unallocated shares only if it determines that implementing the pass-through voting and tendering procedures is consistent with ERISA and participants receive prior notice that the unallocated shares will be voted in the same ratio as votes with respect to the allocated shares.

(iii) Section 203 of the DGCL generally precludes an acquiror from engaging in a business combination with the target for three years after acquiring 15% or more of the target's outstanding voting stock, unless, among other exceptions, the acquiror owns, as a result of the stock acquisition transaction, at least 85% of the outstanding voting stock of the target. Shares held by an ESOP are not considered outstanding shares for purposes of the 85% calculation unless the plan provides for confidential tendering of the ESOP's shares by the ESOP participants. Thus, in cases where a Delaware corporation's ESOP owns more than 15% of its outstanding voting stock and provides for confidential tendering of ESOP shares by participants, a potential acquiror will have to receive tenders from certain ESOP participants in order to avoid the three-year waiting period requirement for business combinations. Such conclusion is dependent on the ability of an ESOP trustee to "pass through" voting and tendering decisions with respect to unallocated shares.

3. <u>MultiEmployer Pension Plans</u>.

(a) Multiemployer pension plans are labor union pension plans to which more than one employer contributes pursuant to a collective bargaining agreement. The Multiemployer Pension Plan Amendment Act of 1980 created what is now referred to as "withdrawal liability" of an employer upon a complete or partial withdrawal from a multiemployer pension plan. This liability of an employer for withdrawal from a multiemployer plan, as opposed to a single employer plan, imparts no liability to the PBGC but does require continued funding of such liability over a period not to exceed 20 years.

(b) If a target is acquired pursuant to a sale of stock, no withdrawal liability will result because although the ownership of the employer is changing, the entity obligated to make contributions is not changing.

(c) If a target is acquired pursuant to a purchase of assets and the acquiror agrees to contribute to the multiemployer plan on behalf of transferred employees, the seller may require, in order to relieve itself of any withdrawal liability, that the acquiror post a bond to the plan or place funds in escrow for the plan, unless waived by the PBGC. The bond or escrow amount will be in an amount computed by reference to the seller's annual plan contributions that will be canceled or refunded, as the case may be, after 5 plan years. The seller must be secondarily liable, pursuant to the asset purchase agreement, in the event that the acquiror withdraws from the plan within 5 years of the sale and fails to make withdrawal liability payments. The acquiror may not be required to post a bond if the withdrawal liability is de minimis and target and acquiror timely file a notice and request for variance with the multi-employer plan.

4. <u>Special Tax Considerations for Taxable Transactions</u>. The transaction may result in a possible loss of deduction for excess contribution credit carried forward for prior years' contributions by the target to the pension, profit sharing or other tax-qualified plan and a possible excise tax on excess contributions.

5. <u>Welfare Plans</u>.

(a) Welfare plans may be assumed or terminated if permitted by the plan documents (including any descriptions distributed to employees).

(b) The funding status of any funded welfare plan should be determined. Lower-funded plans may result in additional costs to the acquiror. Contributions to fully-funded plans may not be deductible. Welfare funds may also be subject to tax on their unrelated business taxable income (though collectively bargained plans are exempt).

(c) If a welfare plan has failed to provide continuation health coverage to employees and dependents, as required by The Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), substantial penalties may apply.

(d) An acquiror and a seller may agree to allocate responsibility for COBRA continuation coverage by contract. In the event the responsible party fails to perform, the default party is the seller, provided the seller continues to maintain a group health plan. If, however, the seller ceases to maintain a group health plan in connection with the sale, the acquiror will be liable for maintaining COBRA coverage if the transaction is a stock sale or if the transaction is an asset sale in which the acquiror continues the operation of the business without interruption or substantial change.

(e) FASB requires that companies disclose in their financial statements the extent of their obligations to pay post-retirement health, life insurance and other welfare benefits, as well as the funding status of such obligations, in a manner similar to the rules for pension disclosure. Such obligations can represent a significant balance sheet liability for a target and its potential acquiror.

(f) State law issues may arise if a plan covers employees of more than one controlled group.

6. Compliance.

(a) Due diligence is necessary as to past compliance where a plan is assumed, for example, with respect to prohibited transactions, funding, reporting deficiencies or disqualification of the plan. The target should make a compliance representation and provide an indemnity covenant in the purchase agreement. It should also be determined whether a plan (including any welfare plan) is in compliance with recent changes in the law.

(b) In a stock acquisition, due diligence is necessary to determine any pension liabilities of any member of the target's controlled group that may become liabilities of the target, the acquiror and their new controlled groups.

(c) Where the target's plan is to be assumed, the acquiror should consider the expense and complexity of ongoing compliance and administration. This would include the correction of any compliance defects, necessary administrative changes and any plan amendments required under recent legislation or regulations.

(d) Where the target's plan is to be assumed, the acquiror should determine whether additional employees of the target, the acquiror, or both, require plan coverage satisfy the Code's non-discrimination and minimum participation rules.

(e) If the target has no plan or its plan is terminated, it is necessary to determine whether the existing plans of the acquiror will continue to satisfy the Code's non-discrimination rules after the target's employees are integrated into the acquiror's workforce.

(f) It should be determined whether COBRA continuation health coverage must be provided to any terminated employees and their dependents.

7. Executive Plans and other Non-ERISA Plans.

(a) Stock plans include restricted stock plans, incentive stock option plans, non-qualified stock option plans, stock appreciation rights and other non-qualified stock bonus plans.

(i) It should be determined whether target employees will be required to surrender rights under the stock plan for cash payment or other consideration or whether there will be a discretionary acceleration of vesting and/or exercise due to the acquisition. Any such acceleration that is discretionary (as opposed to occurring automatically under the plan's terms upon a change in control) will result in the option's being deemed a re-granted option for financial accounting purposes, resulting in an expense charge if the value of the stock has appreciated since the original grant.

(ii) Consent of plan participants may be required to modify their rights under the stock plan.

(iii) 1934 Act Section 16(b) issues may need to be addressed. Pursuant to a no-action letter issued by the SEC in January 1999, the conversion or cancellation of target equity securities and "derivative" securities (such as stock options) eligible for exemption under Rule 16b-3(e) of the 1934 Act under certain circumstances, provided the board of directors, or an appropriate committee, of the target approves the specific terms of the conversion or cancellation.

(iv) 1933 Act registration issues may need to be addressed (Form S-8).

(v) It should be determined whether benefits under such plans that are payable upon the acquisition constitute "excess parachute payments." Excess parachute payments are subject to adverse tax consequences. Non-public companies (sellers and targets) can avoid such adverse consequences through proper disclosure and obtaining shareholder approval vote on the excess parachute payments prior to the acquisition.

(b) Non-stock plans include deferred compensation plans, cash bonus plans, supplemental executive retirements plans ("SERPs"), excess benefit plans, incentive plans and severance plans and funding arrangements (Rabbi and Secular Trusts).

(i) It should be determined if payment is required under the non-stock plan regardless of ownership of target. Non-stock plans may require payments to be made in the future or over several years.

(ii) Non-stock plans may require payments to executives upon acquisition or only upon actual or constructive termination of employment after the acquisition.

(iii) It should be determined whether benefits constitute "excess parachute payments." (See XIX.A.7.(a)(v) above.)

(iv) Acquiror may be required to amortize the cost of any assumed deferred compensation obligation as an acquisition cost.

8. Severance Plans. In an asset transaction, the target's severance plan should be reviewed to determine if benefits are payable even if an employee is offered employment with the acquiror.

B. Environmental Matters. Environmental liabilities may be imposed on an acquiror by statute or common law, despite an agreement between the parties that the seller will retain all such liabilities. The seller, however, can agree to indemnify the acquiror against such liability. Because environmental liabilities can be so costly, they should be considered in connection with price and other initial matters of negotiation. To determine the range of such costs, the acquiror or a financial institution may request an environmental audit of the seller's facilities. The agreement should include environmental representations, warranties and indemnities, a clean-up plan under certain circumstances, and, where required, reference to notification to or prior approval by certain regulatory agencies.

1. The Sources of Environmental Liability.

(a) Clean up Costs. Under CERCLA or "Superfund" (as it also known), the Resource Conservation and Recovery Act ("RCRA"), and various state statutes, liability for clean-up of hazardous substances is potentially imposed on the present owner or operator of a facility from which there is a release of hazardous substances as well as all former owners or operators who were such at the time a disposal occurred and any person(s) who arranged for disposal or treatment of hazardous substances at a site from which there is a release of hazardous substances, including any transporter(s) who selected the site and shipped to it. The "strict" liability imposed by the statutes is joint, several and retroactive such that:

(i) each potentially responsible party ("PRP") for a clean-up is statutorily liable for the entire cost of the clean-up, although generally each PRP's share of liability is determined by the portion of waste which such PRP contributed to the site as a percentage of the total waste contributed to the site by all parties able to share in clean-up costs;

(ii) statutory liability cannot be transferred by contract (parties can, however, agree to indemnify each other); and

(iii) liability is incurred even if the action that caused the release of hazardous substances was legal at the time it took place.

(b) Regulatory Risks. The Clean Air and Clean Water Acts, RCRA and numerous other Federal and state statutes regulate emissions, discharges, storage, treatment and disposal of chemicals and other substances through permit systems, standard setting and other requirements. The failure of a seller to have complied with these environmental laws as well as the future costs of compliance may impair the operation of a facility in the following ways:

(i) the facility may incur monetary penalties and possible shut-down;

(ii) the cost of installing pollution control equipment can be substantial;

(iii) expansion of a facility or modification of its potential emission sources may trigger new standards that are far more stringent than existing controls; and

(iv) regulatory changes, such as regulations under the Clean Air Act can result in significant future costs which should be considered during an acquisition.

2. Environmental Audits. An environmental audit, generally referred to as a "Phase I", is advisable in all significant transactions involving industrial facilities in order to evaluate the extent of potential liabilities. Phase I audits are usually conducted by a team of environmental engineers and attorneys. Such audits typically involve a review of documents, site visits which include interviews of employees, a walk-through of the facility, review of data bases of regulatory information and property records on the target site and its neighbors, contacts with regulatory authorities as appropriate to ascertain the extent of compliance and pending developments and preparation of a report and an estimate of potential costs. Based on the findings of the Phase I audit, an acquiror may also wish to conduct a Phase II audit, which involves sampling of soil and perhaps groundwater, to determine whether there is contamination. Phase I and Phase II audits may pose substantial questions related to attorney-client and other privileges as well as disclosure requirements.

3. The Acquisition Agreement.

(a) Representations and warranties assist the acquiror to understand the extent of the seller's environmental problems. The seller should be asked to state that:

(i) it has obtained and is in compliance with all terms in permits, licenses and authorizations as well as all provisions of environmental laws, decrees, judgments, notices, etc.;

(ii) there is no pending or threatened litigation or compliance order;

(iii) there have been no reportable discharges or releases of hazardous substances or disposal of hazardous substances on site (there should be a broad definition of hazardous substance);

(iv) there have been no PRP notices received or threatened;

(v) there are no environmental liens affecting the property;

(vi) the properties have no asbestos containing material or PCB containing equipment, and no underground storage tanks have been or are located on the properties or those that are in place comply with law and have not leaked;

(vii) all reports of audits or inspections of the properties have been provided to the buyer (including insurance company reports, internal or external environmental reports, notices of violation, OSHA inspection reports, etc.);

(viii) the seller has not entered into any agreement to indemnify another party for environmental losses; and

(ix) there are no known conditions which may prevent continued compliance with applicable law or give rise to environmental liability.

(b) The acquiror should seek indemnification for:

(i) inaccurate or incomplete representations and warranties;

(ii) liability to third parties for personal injury, property damage and natural resource damage;

(iii) clean-up costs, including both on site (whether or not caused by the seller) and off site liability;

(iv) penalties and other costs resulting from non-compliance with environmental laws prior to closings; and

(v) capital expenditures and other costs to bring the facility into compliance with law.

(c) With regard to indemnities, it is important to note that:

(i) an indemnity with respect to compliance with applicable law should be sufficiently broad to entitle the acquiror to costs incurred in connection with environmental clean-up, even if at the time of the acquisition the environmental contamination (particularly of groundwater) had not yet been declared a nuisance or an imminent and substantial hazard to the environment, or did not occur at a designated Superfund site; and

(ii) the party who is responsible for clean-up should be specified as well as the parameters of the clean-up, in an effort to minimize potential problems in enforcing an indemnity provision.

4. <u>State Notifications</u>.

(a) Under New Jersey's Industrial Site Recovery Act, in certain circumstances, prior to closing, the state must be notified of transfers and the seller must either clean up the site or agree to clean up after closing and provide financial assurance adequate to cover clean-up.

(b) In Connecticut and certain other states, the state and/or the purchaser must be notified of any on-site contamination or other environmental conditions.

(c) Environmental permits, including those issued under the Clean Air and Clean Water Acts, RCRA and other Federal and state statutes, must be transferred from the seller to the acquiror. Requirements differ substantially between states and particular statutes, ranging from a simple letter notifying the relevant governmental authority of the transfer to a requirement that a new permit application be filed and approved prior to closing.

C. <u>Product Liability.</u>

1. <u>Applicable Law</u>. Liability for personal injury or commercial damages caused by a product is presently governed by the laws of the individual states. Proposed Federal legislation ameliorating the plight of product manufacturers and sellers has been considered for a number of years and with the recent change in party control in Congress, seems more capable of enactment now than it was earlier. If desired, and timely requested, a plaintiff is entitled to have claims tried by a jury, unless the jury right has been knowingly waived. It is commonly believed that jurors are biased in favor of the injured consumer or user of a product. Jury verdicts have far outstripped inflation, particularly in large heavily populated states like California, New York and Texas and other urban centers.

2. <u>Commercial Product Liability</u>. Commercial product liability disputes are contract disputes cast in the form of a product liability or breach of warranty suit. Disclaimers of consequential damages and other contractual defenses are typically used to limit commercial liability, but are ineffective as to tort liability.

3. <u>Causes of Action</u>. In the personal injury context, a manufacturer will be held liable if its product is found to be unreasonably dangerous and causes injury, regardless of when it was purchased or how the injury occurred, although among the potential defendants, such as the manufacturer of the product and the company operating the product at the time of the injury, liability is generally apportioned. Theories based on fault, such as negligent design or manufacture, are possible. However, product liability cases often do not focus on the manufacturer's fault but rather on whether the product was unreasonably dangerous or whether the warnings accompanying the product were adequate. Knowledge and intent of the manufacturer may be relevant in assessing punitive damages.

4. <u>Assumption of Product Liability</u>. Product liability is assumed upon a merger and it follows the company when its stock is acquired. An acquisition of assets (in lieu of an acquisition of stock or a merger) may limit the liabilities to be assumed, so as to exclude liabilities on account of products manufactured or sold prior to the acquisition. Depending on the state, however, a court may allow a

plaintiff to recover from the purchaser of the assets if no recovery is otherwise available from a solvent seller or if the purchaser uses the purchased assets to continue the business of the seller.

5. Insurance. Product liability insurance is available in many industries, but is generally expensive. In certain high risk industries, however, it may be unavailable or available only at limits and premiums which are not commercially acceptable. Generally, product liability insurance will not provide coverage for punitive damages.

D. Intellectual Property Matters.

1. Definitions. Intellectual property encompasses patents, trademarks, trade dress, copyrights, trade secrets and other forms of technical know-how.

(a) Patents. Pursuant to a Federal statutory scheme, patents protect "discoveries" of "inventors" against unauthorized making, using, selling or offering to sell (and, in certain cases, importing/exporting) the invention in the United States for a period of 20 years from the date on which the application for the patent was first filed in the United States. A patent holder may legally exclude all others from using the discovery for the term of the patent.

(b) Trademarks/Service Marks. A trademark or service mark is any word, name, symbol or device, or any combination of these, adopted and used by the owner to identify and distinguish the owner's goods or services from the goods or services offered by others. Protection for trademarks and service marks is available under both Federal and state laws and continues in force for as long as the mark is in use.

(c) Copyrights. Pursuant to a Federal statutory scheme, copyrights protect the "writings" of "authors" against unauthorized copying. Protection extends to the expression of an idea, not the idea itself. Unlike patents, independent creation of a copyrighted item is not actionable.

(d) Trade Secrets. A trade secret is "any formula, pattern, device or compilation of information which is used in one's business, and which gives one an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers." Restatement of Torts § 757 comment b (1939). Protection is available under state law only.

(e) Trade Dress. The term "trade dress" includes any product configuration or appearance adopted and used by a manufacturer or merchant to identify goods and services and to distinguish them from goods and services of others. It is through actual use of a trade dress in connection with a product or service that one establishes protectable trade dress rights. Protection for trade dress is available under both Federal and state laws.

2. Characteristics. Intellectual property is intangible; however, it does share some of the characteristics of real property. For example:

(a) Transferability. Intellectual property can be transferred in whole or in part, and may be taxed;

(b) Licensing Revenue. Intellectual property can generate revenue via licensing; and

(c) Security Interests. Security interests can be granted in certain kinds of intellectual property (filing requirements vary depending on the type of intellectual property involved).

3. Value. Intellectual property may be the backbone of a company or it may be of marginal value. The greater the importance, of course, the greater the need to precisely define the contours of that property and determine its current viability. This can be difficult given the intangible nature of intellectual property.

4. Due Diligence. The thrust of any initial investigation should be on identifying all intellectual property, including trade names, and verifying the chain of title to that intellectual property. Lists should be

compiled of all patent, trademark and copyright registrations and applications, as well as work in progress. Trade secrets and other technical know-how should be identified. Licensing arrangements should be reviewed. A thorough due diligence investigation should be conducted to determine the present viability and status of the seller's various intellectual properties.

5. Evaluation of Rights. The rights to intellectual property can be lost over time for a number of reasons, including non-use, the failure to file requisite fees, inappropriate licensing and abandonment. For instance, with respect to trade secrets, failure to treat the matters as privileged and confidential can often lead to the information becoming public knowledge. No rights to that knowledge can then be claimed. Under Federal trademark law, a mark is presumed abandoned if it is not used in the ordinary course of trade for a period of three years. For patents, failure to pay maintenance fees annually or at specified times (e.g., in the U.S. at $3^1/_2$, $7^1/_2$, and $11^1/_2$ years from issuance) will result in forfeiture.

6. Future Plans. An acquiror should identify its post-acquisition plans for use of intellectual property and discuss such plans with counsel. An investigation of the rights to intellectual property in jurisdictions in which the acquiror does or intends to do business may be appropriate, especially if the seller does not use its intellectual property in such jurisdictions.

7. Assignments and Filing Costs. Finally, the economics of transferring the intellectual property must be assessed. At times, the cost of preparing and properly filing the requisite documents outweighs the benefit afforded by that property. For example, it may cost nearly $1,000 to assign one foreign trademark registration. Foreign trademark agents and filing fees range from about $350 to $600. For patents, the current Federal fee is $40 per patent or patent application. In certain foreign countries, notably the United Kingdom, the assignment fee is based on a percentage of the total value of the property being transferred. When hundreds of foreign trademark registrations are involved, the cost of preparing and filing the requisite assignments must be considered.

E. Labor and Equal Employment Opportunity Matters.

1. Labor Matters.

(a) If a labor union represents the target's employees, it becomes independently significant whether the transaction involves the purchase of stock or the purchase of assets. If the transaction involves the purchase of stock, the acquiror must continue to recognize the union and must assume any preexisting collective bargaining agreement. If a preexisting agreement continues in force it may restrict changes in operations.

If, on the other hand, the transaction involves the sale of assets, the acquiror may or may not be required to recognize the union, depending on the percentage of the acquiror's new work-force that is comprised of the target's union employees. Generally, if fewer than half of the acquiror's employee complement previously had been union employees of the target, the acquiror need not recognize the union. If at least half of the acquiror's employee complement are former union employees of the target, the acquiror must recognize the union, but has the option of either continuing with the existing collective bargaining agreement or negotiating a new agreement (and risking a potential strike).

(b) If some operations are to be closed, there must be negotiations with unions about effects of closing on employees. It is customary for unions to demand severance pay for such employees.

(c) The Federal Worker Adjustment and Retraining Notification Act requires that in many circumstances an employer give advance notice of a plant closing or mass layoff if it will result in an employment loss at a site of employment. The notice, when required, must be distributed to the affected employees (or their union representative, if such exists) and to the local governmental authorities.

2. Equal Employment Opportunity Matters.

(a) The acquiror may succeed to liabilities of the target for unlawful discrimination on the basis of race, sex, religion, national origin, age or disability.

(b) Laws prohibiting discrimination on the basis of national origin may restrict the right of a foreign owner to give preference to its own nationals in the management of the target, unless such preference is protected by treaty.

F. Immigration Matters.

1. Possible Consequences Upon Acquisitions or Related Changes. Immigration consequences flowing from business entity changes may significantly affect (x) an employer's eligibility to confer a particular work visa classification, or (y) an alien-worker's ability to work or hold permanent resident status. Many events trigger immigration consequences. Some of them are as follows:

(a) Ownership. Stock or asset ownership changes in a business (e.g., a percentage reduction of corporate ownership to less than 50%, or losing controlling interest in an entity);

(b) Activity. Change in an entity's business activity (e.g., a corporate dissolution or a termination or reduction of trading activity);

(c) Location. Change in the business location of the entity; and

(d) Employee Changes. Changes in an alien-worker's job location, title or duties, managerial or executive responsibilities, or use of essential skills or specialized knowledge regarding the business.

2. Foreign Personnel. Following an acquisition of a United States business entity, a foreign acquiror may wish to employ foreign personnel in the target company for temporary periods. The United States immigration laws provide for admission of foreign personnel in several temporary working categories, including, among others, the L-1, H classifications, E-1/E-2 and B-1 categories, provided that highly specific requirements are satisfied.

(a) The L-1 category for intracompany transferees from the parent company (or an affiliate) permits foreign personnel to work for the target (or an affiliate) for an initial period of up to three years, with extensions of generally up to four years, provided the foreign personnel worked abroad for the same company, branch or affiliate for at least one year within the three preceding years in an executive, managerial or specialized knowledge capacity, and the position in the United States will be in one of those capacities. The total period of stay may be seven years for L-1A managers and executives and five years for L-1B specialized knowledge employees.

(b) The H category covers temporary workers and trainees and may be granted for an initial three-year period with future extensions totaling an additional three years. The Immigration Act of 1990 added a labor attestation requirement for the H-1B nonimmigrant classification. The H-1B visa may be used to bring a worker temporarily to the U.S. if the employee will work in a "specialty occupation" or a professional position. The attestation generally requires an employer to state that it will comply with certain wage, working conditions and notice requirements before hiring an H-1B worker. The American Competitiveness And Workforce Improvement Act of 1998 ("ACWIA") granted an increase in the number of H-1B visas available for fiscal years 1999 and 2000. It also imposed upon employers new obligations in hiring and in terminating employment of workers utilizing the H-1B visa. In addition, an increased filing fee per petition (on top of the old filing fee) was assessed upon employers to fund education, training and scholarship programs for U.S. workers. The legislation made numerous modifications which included tightening of some existing requirements and the addition of others, making it more difficult to hire H-1B nonimmigrant workers. These provisions remain in effect.

The American Competitiveness in the Twenty-First Century Act ("AC21") provides short-term relief to the problem of insufficient supply of H-1B numbers and the resulting inability of the U.S. immigration system to accommodate the expanding needs of U.S. employers for foreign national professionals. The AC21 temporarily increases H-1B numbers to 195,000 for fiscal years 2001, 2002 and 2003.

(c) The E-1/E-2 (treaty trader/treaty investor) categories depend on the existence of a treaty between the United States and the country of the foreign acquiror and foreign personnel. The foreign acquiror and the foreign personnel must be nationals of the same treaty country as the enterprise. The acquiror must have a minimum ownership interest of fifty percent and the foreign personnel must propose to work in a capacity generally comparable to any one of the capacities referred to above in connection with the L-1 category. The advantage of the E visa over the other nonimmigrant visa categories is that its duration, set initially at one year, can be extended almost indefinitely.

(d) Foreign persons can enter the United States as business visitors pursuant to the B-1 category to set up a new business or to work in the United States in specified capacities, as long as they do not receive any salary from a United States source. Extensions of the B-1 category beyond the initial six-month period are generally difficult to obtain.

The foregoing categories permit the foreign person to be accompanied by spouse and unmarried minor children, but do not include authorization for such family members to work in the United States. Processing of applications by the Immigration and Naturalization Service and/or a United States Consulate abroad may require several days or weeks.

3. Sanctions. Any foreign business entity gaining control of a United States business entity through a merger or acquisition should be aware of sanctions applicable to any employer in the United States (United States or foreign owned). The Immigration Reform and Control Act of 1986 subjects such an employer to civil, and sometimes criminal, penalties for knowingly hiring an alien who does not have work authorization, or for permitting the alien to continue to work after the work authorization has expired. An employer may also be penalized for failing to verify each employee's work authorization, even if the person is a United States citizen or lawful permanent resident, and for failing to keep the verification record for the required period.

G. Dispute Resolution Mechanisms.

1. Alternative Dispute Resolution. The parties to an agreement may wish to include a provision for non-judicial dispute resolution. Because the U.S. and most other nations are parties to the U.N. Convention on Recognition and Enforcement of Arbitral Awards (the "New York Convention"), a foreign arbitral award is easier to enforce in some jurisdictions than a foreign judgment.

(a) Arbitration. Provisions requiring arbitration are generally enforceable under Federal law. Arbitration may be conducted pursuant to the rules of established arbitral tribunals, such as the American Arbitration Association ("AAA"), the International Chamber of Commerce ("ICC"), the Stockholm Chamber of Commerce or privately agreed to procedures. The main advantage of an "administered" versus an "ad hoc" arbitration is that arbitration under the direction of the established tribunals provides a mechanism to appoint arbitrators and deal with other procedural issues in the event that one party is recalcitrant.

(b) Which administrative tribunal should be chosen? The procedures and costs of the various established arbitral forums can vary greatly. Because the ICC sets its administrative fees and the arbitrators' compensation based upon a percentage of the amount in controversy, ICC arbitration tends to be more expensive, particularly in large commercial cases. If the agreement provides for arbitration under the auspices of the AAA, be aware that the AAA has several sets of rules that should be considered. Either the "AAA Commercial Arbitration Rules" or the "AAA International Arbitration Rules" should be designated. The AAA "Supplemental Procedures for Large, Complex Disputes" should also be considered to be designated if the amount in controversy will exceed roughly $1 million. The AAA generally assigns more experienced administrators and selects a panel of more sophisticated (and expensive) arbitrators when these procedures are designated in the agreement. These procedures are designed to be used in conjunction with any of the AAA's rules.

(c) Other alternative dispute resolution mechanisms. Alternative dispute resolution mechanisms other than arbitration are generally non-binding, and are aimed at assisting the parties in reaching a settlement. One such device is mediation, a managed form of negotiation in which a neutral individual endeavors to bring about a compromise between two sides. Mediation may be used in conjunction with an arbitrator, as a mandatory pre-arbitration step. A similar device is the non-binding "mini-trial," in which the attorneys for each party present their best arguments to an assembly of the principals, who use the presentations as a frame of reference in attempting to settle their dispute. It is very important to place a time limit on any non-binding mechanisms.

2. Agreement Provisions. If an agreement is to include an arbitration clause, the following issues, among others, should be considered:

(a) Does the contemplated transaction involve parties based in different nations? If so, it may be subject to the New York Convention. In New York Convention transactions, the place of the arbitration should be provided for specifically, because that is the only jurisdiction in which an arbitral award can be challenged. Because certain judicial equitable relief may not be available in New York Convention matters, the parties should consider whether the arbitrators should be granted specific authority to order equitable remedies. Any such provision, however, should state that it does not restrict the parties' right to seek judicial equitable relief prior to the appointment of arbitrators.

(b) Other considerations in selecting a forum. Several other considerations should govern the decision of where to place the arbitration, particularly if the parties are from different countries. First, holding the arbitration in a country that is a party to either the New York Convention or the Inter-American Convention on International Commercial Arbitration (the "Panama Convention") enhances the likelihood of enforceability of any award. Although most commercial countries are signatories to one of these conventions, there are significant exceptions (e.g., Saudi Arabia, Portugal, and Brazil). Second, arbitrations are subject to the procedural rules governing arbitration of the state in which they are seated. These procedural rules will govern, for example, the level of judicial intervention in an arbitration. In general, the best places to conduct an arbitration are those that limit the role of the courts. Finally, the forum chosen should be geographically convenient for the parties. (The parties may, however, wish to build in a disincentive by requiring a claimant to initiate arbitration in the respondent's home jurisdiction.) It should be kept in mind, however, that the arbitrators are not precluded from hearing evidence in locations other than the official arbitration site if they are persuaded that such locations are more convenient for the parties or witnesses.

(c) What law governs? Some states have rules or procedures unfavorable to speedy arbitration. California law, for example, permits arbitrations to be stayed pending resolution of related court cases. New York law allows a respondent to stay an arbitration in order to seek a dismissal in court based upon statute of limitations defenses. Where there is doubt concerning the arbitration law of a particular jurisdiction, the arbitration clause should expressly provide that the choice-of-law clause is not intended to incorporate state rules that obstruct, delay or otherwise disfavor arbitration. It may be useful to determine what equitable or ancillary relief in aid of arbitration would be available from a particular state's court. Such emergency court relief may be necessary if, for example, a key employee leaves with trade secrets.

(d) What will the language of the proceeding be? In arbitrations involving parties from countries with different languages, the agreement should designate the official language of the proceeding.

(e) Do the parties wish to disclaim liability for punitive damages? Unlike other contracts, an arbitration agreement may disclaim punitive damages liability. It is important to spell out clearly the parties' intent that punitive damages (or any other type of relief, such as consequential damages) be limited or placed beyond the arbitrator's power. Although New York law used to prohibit arbitrators from awarding punitive damages, that prohibition has recently been struck down by the U.S. Supreme Court. Mastrobuono v. Shearson Lehman Hutton, Inc., 115 S.Ct. 1212 (1995). After Mastrobuono, if preclusion of an award of punitive damages under an agreement governed by New York law is desired, it must be expressly provided for in the agreement.

(f) Should attorneys' fees and costs be awarded to the prevailing party? Under the "American Rule," the prevailing party is not entitled to recover its attorneys' fees unless such an award is provided for specifically. Both the ICC and AAA rules give arbitrators broad discretion to apportion the costs and expenses of arbitration among the parties. One key difference is that the AAA Commercial Arbitration Rules do not provide for the apportionment of attorneys' fees while the AAA International Arbitration Rules and the ICC rules do. If the AAA Commercial Arbitration Rules will be used and the parties wish to have attorneys' fees awarded to the prevailing party, the parties should expressly provide for that in the agreement.

(g) Should the agreement accord one party the unilateral right to opt for arbitration? The enforceability of unilateral clauses is subject to some question.

(h) Do the parties wish to specify the number and qualification of the arbitrators? Most arbitration clauses specify either that the dispute be decided by a single arbitrator or by a panel of three arbitrators. Many arbitration clauses provide that each party shall appoint one arbitrator who acts as that side's advocate on the panel; the two partial arbitrators then appoint a neutral arbitrator. (The party-selected arbitrators in AAA arbitrations often play a more active role as quasi-advocates than their ICC counterparts thus to some extent making the chair almost a de facto single arbitrator.) A panel is more expensive and more likely to render a compromise verdict than a single arbitrator; on the other hand, parties often feel safer when they are not exposed to the inclinations of a solitary decision-maker. In a post-closing value arbitration, the arbitration clause could and, probably should, require that the arbitrator be an accounting firm.

3. Other Provisions. If the parties do not wish to arbitrate, there are other means of removing or reducing some of the uncertainties related to litigation. Waiver of jury trial, selection of forum, choice of law and submission to jurisdiction are all examples of provisions which, if agreed to, might reduce procedural jousting and focus any litigation on the merits although New York by statute gives effect to clauses mandating New York jurisdiction and New York law in contracts having value of $1 million or more. These provisions can be subject to the vagaries of state law.

H. Stock Exchange and NASDAQ-NMS Considerations.

1. General Market Considerations. An acquisition may be subject to time delays, additional expense or procedural constraints due to restrictions imposed on companies listed on a stock exchange (such as the national exchanges, NYSE and AMEX, or various regional exchanges) or traded in the "over-the-counter" market, also referred to as Nasdaq-NMS (which excludes "pink sheet" securities that are not actively traded, administered by the National Association of Securities Dealers, Inc., (the "NASD")). A NYSE listing traditionally afforded companies greater liquidity, prestige and an exemption from the registration requirements of state "blue sky" laws, although the Nasdaq-NMS has increasingly afforded companies similar benefits. The national stock exchanges traditionally imposed greater restrictions in respect of corporate governance matters, principally relating to stockholder approval requirements, although the NASD has adopted rules requiring stockholder approval in specified circumstances. The national exchanges and the NASD generally require:

(a) timely disclosure of material developments, including "immediate" release of matters relating to mergers and acquisitions;

(b) subject to certain exceptions, compliance with one share/one vote rules which prohibit any action which has the effect of nullifying, restricting or disparately reducing the per share voting rights of an outstanding class or classes of common stock; and

(c) compliance with the proxy solicitation rules of the 1934 Act.

2. Listing/Quotation Requirements. An acquiror may seek to provide market liquidity in the United States to the stockholders of the surviving entity. Foreign issuers may establish an ADR facility or, in the event of a more active market, list or seek quotation of their securities in a manner comparable to a United States issuer. Although the listing/quotation requirements of the national exchanges and the NASD vary, they generally include a specified number of stockholders, a specified amount of income, assets and stockholders' equity, and the existence of specialists or market makers in the securities.

3. Corporate Governance Requirements.

(a) NYSE and NASD require stockholder approval of actions resulting in a change of control of the issuer.

(b) NYSE and NASD generally require stockholder approval of the acquisition of a business, company, assets, property, or securities representing any such interest:

(i) from a director, officer or a substantial security holder or from a related entity; or

(ii) if the acquisition could increase outstanding common stock by 20%.

(c) NYSE, AMEX and NASD require stockholder approval for adoption of any option or other special remuneration plan for directors, officers or key employees.

(d) NYSE, AMEX and NASD require companies to have at least two "outside" (non-management) directors on their board and to maintain an audit committee comprised of at least a majority of outside directors (or solely of outside directors in the case of the NYSE).

(e) NYSE, AMEX and NASD require newly issued shares of a listed/quoted class to be approved for listing/quoting.

I. European Union Considerations.

It is now possible that a merger or acquisition involving only United States companies could trigger certain legal requirements within the European Union ("EU").

1. On September 21, 1990, the Merger Control Regulation ("MCR") came into effect. As a result, the European Commission now has authority to screen in advance those mergers and acquisitions (regardless of the nationality of the companies involved) in which:

(a) the groups to which the merging companies belong have world-wide sales of ECU 5 billion (about $6.2 billion as of the publication of this document);

(b) at least two of the groups to which the merging companies belong have sales in the EU of ECU 250 million (about $311 million); and

(c) the companies involved have sufficient business in more than one EU Member State.

2. In principle, the MCR could affect mergers between or among non-EU companies, including, for example, two United States corporations, if the above requirements are met.

3. Mergers and acquisitions which do not meet the above thresholds may still be subject to regulation by the individual EU Member States.

4. Failure to comply with the obligation under the MCR to notify the European Commission of any merger or acquisition before it is put into effect may result in the transaction being declared void and substantial fines (e.g., 10% of the companies' annual sales) and the imposition of periodic penalty

payments, maximum ECU 100,000 per day for each day of delay in complying with what has been ordered.

5. A merger or acquisition that involves an EU company may trigger other EU or Member State requirements.

NOTES

NOTES

For more information, please contact us at:

Pillsbury Winthrop Shaw Pittman LLP
1540 Broadway
New York, NY 10036-4039
212.858.1000

www.pillsburylaw.com