NEW December 2021 Edition of
Mergers, Acquisitions, and Buyouts

by Martin D. Ginsburg, Jack S. Levin, and Donald E. Rocap

We are proud to enclose the December 2021 edition of Ginsburg, Levin, and Rocap's **Mergers, Acquisitions, and Buyouts.**

Here is a summary of major developments reflected in the new edition, written by co-authors Jack S. Levin and Donald E. Rocap, senior partners in the international law firm of Kirkland & Ellis LLP.

Highlights of the New Edition

- **SEC substantially increased the amount of securities a business entity can issue without a full-blown 1933 Act filing, effective 3/15/21:**
  - SEC Reg. D Rule 504 allowing a business entity to issue securities without 1933 Act registration in a private placement has been amended to allow such an issuance as large as $10 million (rather than up to $5 million previously).
  - SEC Reg. Crowdfunding allowing a business entity to issue securities without 1933 Act registration in a type of public offering conducted on the internet has been amended to allow such an issuance during a 12-month period as large as $5 million (rather than up to $1 million previously),
    - and to allow most individual investors to purchase a larger amount of such crowdfunding securities than was previously allowed.
  - SEC Reg. A allowing a business entity to issue securities using an abbreviated 1933 Act registration statement has been amended to increase the maximum to $20 million for a Reg. A Tier 1 offering and $75 million for a Reg. A Tier 2 offering. See discussion at ¶1702.11.1 and ¶1702.11.2.

- **SEC clarified integration rules, effective 3/15/21.** When P issues securities over an extended period of time, it is often unclear whether for 1933 Act purposes (including for Reg. D, Reg. Crowdfunding, and Reg. A) such stock issuances constitute (1) a single integrated stock offering or (2) multiple separate stock offerings. For many years SEC utilized a *subjective* integration test based on 5 vague factors.

However, effective 3/15/21, SEC abandoned its 5-factor test and adopted new SEC Rule 152 containing a complex series of more detailed integration principles. Rule 152 is divided into 2 parts: 4 objective (and complex) safe harbors (described immediately below) and 2 general principles (discussed thereafter) which apply if an offering does not fit into 1 of the 4 objective safe harbors.

4 objective integration safe harbors

(1) Multiple offerings separated by more than 30 days. If 2 offerings (whether or not 1933 Act exempt) are separated by more than 30 days from the completion or termination of 1 offering and the commencement of another offering, the 2 offerings are not integrated. However, as an exception to this 30-day rule, if:

(a) the first offering allows general solicitation and advertising (e.g., Reg. A, Reg. Crowdfunding, Reg. D Rule 506(c), Reg. D Rule 504 using the 3 state law exceptions, or a 1933 Act registered public offering) *and*

(b) the second offering is a 1933 Act exempt offering that prohibits general solicitation and advertising (e.g., Reg. D Rule 506(b) or Reg. D Rule 504 not using the 3 state law 1933 Act exceptions),

then rule (1) applies only if P (the issuer) has a reasonable belief that each purchaser in the second offering either:

(x) was not solicited through the use of general solicitation and advertising or

(y) had a pre-existing substantive relationship with P (the issuer) prior to commencement of such offering.

(2) Rule 701 and Reg. S offerings. Employee offerings under Rule 701 and offshore offerings under Reg. S are not integrated with any other offerings.

(3) 1933 Act registered offering. A 1933 Act registered offering is not integrated with:

(a) a prior completed or terminated 1933 Act exempt offering for which general solicitation and advertising was prohibited (e.g., Reg. D Rule 506(b) or Reg. D Rule 504 not using the 3 state law exceptions) or

(b) a prior completed or terminated 1933 Act exempt offering for which general solicitation and advertising was allowed (e.g., Reg. A, Reg. Crowdfunding, Rule 506(c), or Reg. D Rule 504 using the 3 state law exceptions), so long as for either (a) or (b) above:

(x) the prior completed or terminated 1933 Act exempt offering was made solely to "qualified institutional buyers" and/or "institutional accredited investors" and

(y) the later 1933 Act registered offering does not commence until more than 30 days after the prior 1933 Act exempt offering was completed or terminated.

(4) Completed or terminated offering. There is no integration for a completed or terminated offering (regardless of whether or not such first offering was 1933 Act registered or does or does not allow general solicitation and advertising) followed by a 1933 Act exempt offering that allows general solicitation and advertising (e.g., Reg. D Rule 506(c), Reg. D Rule 504 using the 3 state law exceptions, Reg. A, Reg. Crowdfunding, or a 1933 Act registered public offering) without requiring a 30-day waiting period.

Integration general principles

If an offering does not fit into any of new Rule 152's 4 safe harbors (discussed above), Rule 152 promulgated several integration general principles, the most important of which is (in the unhelpful words of Rule 152) that "based on the particular facts and circumstances, the issuer can establish that each offering (A) either complies with the registration requirements of the [1933] Act or . . . an exemption from registration is available for the . . . offering" and (B) is not "part of a plan or scheme to evade the [1933 Act's] registration requirements."

Rule 152 then limits this general principle by enunciating 2 specific circumstances that must be satisfied to avoid integration:

(1) Exempt offering prohibiting general solicitation and advertising. A 1933 Act exempt offering that prohibits general solicitation and advertising (e.g., Reg. D Rule 506(b) or Reg. D Rule 504 not using the 3 state law exceptions) is integrated with any other offering unless Newco (the issuer) has a reasonable belief that each purchaser in the exempt offering (which prohibits general solicitation and advertising) either:

(x) was not solicited through the use of general solicitation and advertising or

(y) had a pre-existing substantive relationship with Newco prior to commencement of such offering.

(2) Concurrent exempt offerings each allowing general solicitation and advertising. A 1933 Act exempt offering that allows general solicitation and advertising (e.g., Reg. D Rule 506(c), Reg. A, Reg. Crowdfunding, and Reg. D Rule 504 using the 3 state law exceptions) is integrated with 1 or more "concurrent" 1933 Act exempt offerings that allow general solicitation and advertising if the concurrent offering includes information about the material terms of the other offering, so that each offering must comply with all the requirements for and restrictions on offers under the exemption being relied upon for such other offering.

While new Rule 152 does not define "concurrent," its language suggests that 2 offerings are concurrent if 1 commences before the other is completed or terminated. See discussion at ¶1702.11.3.

- **Code §304.** Although a T shareholder's sale of T stock to P generally produces CG or CL, this general treatment may be overridden by the complicated rules of Code §304 where T shareholders owning at least 50% of T's stock also own at least 50% of P's stock. Where T and P are publicly traded corporations, limits on their ability to ascertain the identity of small shareholders may make it impossible as a practical matter to rule out the possibility that such ownership overlap exists. A 2021 IRS private letter ruling determined that Code §304 would not apply based on an extrapolation of incomplete share ownership information P was able to gather. See discussion at ¶203.

- **Code §338(h)(10) and §336(e).** Several IRS private letter rulings, including a 2021 ruling, permit corporations to "break" related party status that would otherwise prevent achievement of SUB in a transaction under Code §338(h)(10) or §336(e) by testing related party status only after the completion of a series of planned transaction steps. See discussion at ¶206.5(1) and ¶209.1.

- **Capitalization of acquisition expenses.** The Tax Court's 2021 *Tribune Media* decision provides additional guidance regarding the capitalization of transaction expenses in circumstances where alternative transactions are considered and 1 of the alternatives is abandoned. The court distinguished prior cases that had permitted deduction of termination fees paid to a "white knight" bidder (on the ground that the fees were incurred in an attempt to avoid the transaction that ultimately occurred) and, on the *Tribune Media* facts, required capitalization of amounts paid to a "back-up" bidder for the transaction that was ultimately consummated. See discussion at ¶402.11.2(1) and ¶402.12.1.

- **IRS economic-substance doctrine and Code §7701(o).** IRS has long applied the judicial substance-over-form concept as a weapon against tax shelter transactions in which a taxpayer attempts to generate losses, obtain inflated asset basis, or otherwise artificially create tax benefits without any corresponding economic burden. It is unclear whether IRS may apply Code §7701(o) to disregard particular transaction steps that occur as part of a larger transaction that has business purpose.

In the 2021 *Tribune Media* case, the Tax Court addressed IRS's ability, under the partnership "anti-abuse" regulations, to disregard for lack of business purpose a tax-motivated step that is part of a larger non-tax-motivated transaction. These regulations—similar to the language of Code §7701(o)(1)(B)—require that "each partnership transaction or series of related transactions . . . must be entered into for a substantial business purpose."

In *Tribune Media*, IRS argued that a partner's guarantee of partnership debt (which guarantee was not requested by the lender but produced tax benefits to the guarantor) lacked business purpose and as a result should be disregarded for tax purposes. However, the Tax Court rejected IRS's argument on the ground that a business purpose was required for the overall transaction, not for each transaction step, finding that examples in the partnership anti-abuse regulations "establish that a partnership must have a genuine business purpose for forming the partnership, not that every component of the partnership's formation have a separate business purpose."

More broadly, the court viewed this "overall transaction" vs. "transaction step" focus as consistent with general "business purpose" case law, stating that "the courts have interpreted business purpose requirements to apply to whether the entities engaged in the transaction are genuine and profit-motivated or whether the ultimate intent of the transaction has a nontax purpose." See discussion at ¶608.2.

- **New Delaware court decisions on whether P can decline to close acquisition of T because of pandemic's adverse effects on T.** A typical acquisition agreement generally contains closing conditions, the failure of which allow P to refuse to consummate the acquisition (after the agreement has been signed but before closing) in case of certain events, such as (a) material breach of T's contractual R&W and covenants (e.g., to operate the business in the ordinary course between signing and closing) or (b) material adverse change ("MAC") in, or material adverse effect ("MAE") on, T's business. Multiple cases have been filed in the Delaware courts during the global COVID-19 pandemic, often with P seeking to terminate or avoid closing its acquisition of T by asserting that T (i) suffered an MAC or MAE or (ii) breached a covenant to operate in the ordinary course.

  Various Delaware court decisions addressing different facts and differing contractual language have held that:

  (i) T's cost-cutting measures in response to the pandemic were de minimis and consistent with past pre-pandemic practice and therefore did not provide a basis for P to avoid closing.

  (ii) Although the terms "epidemic" and "pandemic" were not included in the list of MAE exceptions, the consequences of the COVID-19 pandemic fell within the MAE exception for effects resulting from "natural disasters and calamities," which (according to the court) is consistent with the normal allocation of

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risks, with P bearing systematic risks beyond the control of the parties and T bearing business risks arising from the ordinary operation of its business (over which T typically has significant control).

(iii) Even if no MAE occurred, T's ordinary-course covenant required T to operate in the ordinary course of its own business practices "measured by its operational history, and not that of the industry in which it operates," and rejected T's argument that the ordinary-course covenant permitted T to engage in "ordinary responses to extraordinary events" by closing down substantial portions of its business due to the pandemic, so that P was permitted to terminate the acquisition agreement.

In light of these decisions, P and T may wish to add clarifying language to an acquisition agreement's MAE clause or "ordinary course" covenant, e.g., (1) P may wish to strengthen the acquisition agreement's customary MAE definition to make clear that T's projections do provide the basis for an MAE assertion and that even a short-term adverse effect on T's assets, liabilities, operating results, or projections, if material, would constitute an MAE, while (2) T may wish to weaken the customary MAE definition to make explicit that T's projections do not provide the basis for an MAE assertion and that only a long-term adverse change, if material, would constitute an MAE or to weaken the "ordinary course" covenant to provide that the covenant is not breached by ordinary responses to extraordinary events. See discussion at ¶1702.13.4.

- **Build Back Better Act, as passed by House of Representatives in 11/21**, proposes to:

  - Adopt a new 15% minimum tax on a corporation's 3-year average "adjusted financial statement income" exceeding $1 billion, for years beginning after 12/31/22.

  - Impose (1) a 5% income tax surcharge on AGI of an individual exceeding $10 million ($5 million for married filing separately) and on AGI of an estate or trust exceeding $200,000, plus (2) an additional 3% surcharge on AGI of an individual exceeding $25 million ($12.5 million for married filing separately) and on AGI of an estate or trust exceeding $500,000, for years beginning after 12/31/21.

  - Revise Code §1202 to permit an individual with AGI of $400,000 or more and any trust or estate (regardless of AGI) to exclude only 50% of gain from sale of Qualified Small Business Stock (rather than current law's 100% or 75%), generally applicable to sales after 9/13/21.

  - Revise Code §163(j)'s business interest deduction limitation by flowing a partnership/LLC's or S corp's interest expense (as incurred) through to the equity owners and applying the deduction limitation at the equity owner level, for years beginning after 12/31/22, rather than as under current law applying the deduction limitation at the entity level.

- Impose a 1% excise tax on a stock redemption (or an economically similar transaction) by a U.S. corporation with stock traded on an established securities market (and also on a purchase of such stock by certain entities affiliated with such a U.S. corporation), applicable to a redemption or stock purchase after 12/31/21.
- Amend Code §361 to reduce distributing corporation (D)'s ability to avoid gain recognition in a divisive reorganization where controlled corporation (C)'s debt obligations (including obligations which are securities) or NQ Pfd stock is received by D and distributed to D's creditors, for a reorganization on or after enactment.
- Expand the Medicare 3.8% net investment income tax for an individual with income above a threshold amount ($500,000 for married filing jointly), by eliminating the exemption for trade or business income (including gain flowing through from a partnership, LLC, or S corp and disposition gain) received by an individual materially participating in the trade or business, applicable to taxable years beginning after 12/31/21.

See discussion at ¶106.3, ¶215.1, ¶1002.1.1, ¶1305.

- . . . **and much, much more** . . .