We are proud to enclose the March 2017 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

1. **T deduction for D&O insurance purchased in connection with P’s taxable acquisition of T.** IRS takes the position that T’s costs of purchasing D&O insurance covering past years, incurred as part of P’s taxable acquisition of T, are deductible by T, rather than capitalizable as an acquisition cost. See discussion at ¶402.10.1(1) (fourth open INDOPCO issue).

2. **Ordinary vs. capital characterization for P and T failed acquisition expenses and breakup fees.** Prior editions of this treatise have included extensive discussion of the issue of when P’s costs and T’s costs incurred in connection with P’s proposed acquisition of T’s stock or assets are taken into account for tax purposes (i.e., as immediate deduction or as amounts required to be capitalized). This edition of the treatise contains expanded discussion of the character—as capital or ordinary—of P’s and T’s deduction for such costs if the acquisition is ultimately not consummated. This edition also expands the discussion of the character (capital gain or ordinary income) of breakup fees received by P or T.

   (1) **P’s expenses in failed acquisition of T’s stock.** Where P incurs expenses in pursuing an acquisition of T’s stock and the Code §263 regulations do not require the expenses to be capitalized (i.e., they are pre-bright line date, non-inherently facilitative expenses), the expenses should be deductible as ordinary expenses under...
Code §162. This is the case whether P is successful or unsuccessful in acquiring T’s stock.

Where P (i) incurs expenses in pursuing an acquisition of T’s stock, (ii) such expenses are required to be capitalized under the Code §263 regulations, and (iii) the transaction is not ultimately consummated, P’s costs should generally be deductible under Code §165, which allows a deduction for any loss sustained and not compensated for by insurance or otherwise. Under general tax principles, such loss should be treated as ordinary rather than capital. Capital loss characterization generally requires a “sale or exchange” of a “capital asset.” Normally, where P has unsuccessfully pursued an acquisition of T’s stock, P has not acquired an asset of any type nor effected a sale or exchange of an asset.

But what seems superficially obvious turns out to be less so due to potential application of Code §1234A, which states that “gain or loss attributable to the cancellation, lapse, expiration, or other termination of . . . a right or obligation . . . with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer . . . shall be treated as gain or loss from the sale of a capital asset.” On some facts, the application of Code §1234A is clear, but that clarity soon turns murky.

Where P (a) enters into a contract to purchase T’s stock from T’s shareholder A, (b) gives A a deposit which A may retain if the stock purchase is not consummated, and (c) ultimately forfeits the deposit, P’s loss on the deposit forfeiture is clearly capital under Code §1234A, because the T stock would be a capital asset in P’s hands, the stock purchase contract is a right with respect to the T stock, and P incurs a loss attributable to the termination of this right.

What is less clear is the extent to which other capitalized costs incurred by P in pursuing the acquisition of T’s stock might also be recharacterized as capital. This issue arises both where P acquires rights clearly covered by Code §1234A (e.g., a contract to purchase T’s stock) and where P acquires rights that are less obviously covered by Code §1234A (e.g., where P’s only enforceable “right with respect to T stock” is an agreement with T’s shareholder granting P an exclusive right for a limited period of time to negotiate an acquisition of Ts stock).

Where P obtains a “right with respect to” T stock within the meaning of §1234A, it does not follow that all of the capitalized expenditures incurred by P in seeking to acquire T’s stock should be allocated to such right, so as to cause the entire amount of P’s capitalized expenses to be taken into account as a capital loss under §1234A. This point is best illustrated where P incurs a minor amount of expenses to negotiate and draft the letter of intent, but the only right acquired by P is under the exclusivity clause of an otherwise non-binding letter of intent.
However, it is likely that substantially all P’s capitalized expenses were incurred subsequent to signing the letter of intent and related not to the letter of intent but to P’s unsuccessful attempt to purchase T’s stock, which was P’s ultimate goal. P’s post-letter-of-intent expenses were incurred by P and required to be capitalized not because they were intended to create, enhance, or defend P’s contractual right (a specified exclusivity period) under the letter of intent, but because they facilitated P’s broader goal of acquiring T’s stock. Only expenses incurred by P to create, enhance, or defend the right with respect to T stock within the meaning of §1234A should constitute capital loss under §1234A. Stated another way, if P’s rights under the letter of intent are treated as rising to the level of a “right with respect to” T stock, such right should also be treated as a “separate and distinct” asset for purposes of the capitalization rules, and only costs directly attributable to that separate and distinct asset should be included in that asset’s tax basis. Other capitalized expenses incurred in P’s failed attempt to acquire T’s stock should produce ordinary deductions under generally applicable tax principles applying outside of §1234A.

The same ordinary versus capital character issue arises where P enters into an ultimately terminated merger agreement with T, which merger agreement provides for a breakup fee payable by P to T or by T to P. The question in this fact pattern is whether Code §1234A applies to the termination of the P-T merger agreement and, if so, what amounts Code §1234A characterizes as capital.

Prior to 2016, IRS’s position appeared to be that §1234A did not apply to breakup fees paid by P to T or by T to P upon the termination of the P-T merger agreement. In recent years, however, the issue of Code §1234A’s scope attracted considerable attention as a result of the Pilgrim’s Pride case. In 2013 the Tax Court held that §1234A mandated capital loss treatment on a taxpayer’s abandonment of high-basis, low-value corporate stock (on the theory that the abandoned corporate stock did constitute “a right with respect to” the abandoned stock because it constituted all of the rights with respect to the stock) but in 2015 the Fifth Circuit reversed the Tax Court’s decision (on the theory that Code §1234A applies only to derivative rights with respect to property and not to the property itself). This attention to Code §1234A apparently resulted in IRS reversing field on application of §1234A to a merger termination fee.

The reversal came in a 2016 IRS Chief Counsel Memorandum addressing the tax treatment of (a) P’s receipt of a breakup fee from T upon termination of a P-T merger agreement following T’s receipt of a superior offer from a third party and (b) P’s capitalized expenses incurred in facilitating its proposed acquisition of T. The memorandum determined that §1234A does apply to the termination of a P-T merger agreement, and that P recognizes (i) capital gain if the termination fee
exceeds P’s capitalized costs in seeking to acquire T’s stock or (ii) capital loss if P’s capitalized costs in seeking to acquire T’s stock exceed the termination fee.

A second 2016 IRS Chief Counsel Memorandum addressed a terminated P-T merger agreement where P paid a breakup fee to T and concluded that P’s “payment of a break fee arising from the termination of an agreement of merger gives rise to a capital loss under section 1234A.” This second 2016 memorandum did not address the tax treatment of P’s capitalized costs in connection with the proposed acquisition.

We believe the two 2016 IRS memoranda were correct in concluding that P’s rights and obligations under a P-T merger agreement intended to result in P’s acquisition of T’s stock do constitute a “right or obligation . . . with respect to property which . . . on acquisition would be . . . a capital asset” in P’s hands. However, we believe the first 2016 IRS memorandum is wrong to include in the §1234A capital gain or loss calculation all of P’s costs required to be capitalized under the §263 regulations as costs of facilitating P’s proposed acquisition of T’s stock. As discussed above, if P’s rights and obligations under the P-T merger agreement are treated as rising to the level of a “right or obligation with respect to” T stock, such right should also be treated as a “separate and distinct” asset for purposes of the capitalization rules. Only expenses specifically incurred by P to create, enhance, or defend the right with respect to T stock within the meaning of §1234A (here, the P-T merger agreement) should be included in P’s tax basis in this asset and taken into account in calculating P’s capital loss under §1234A. Other capitalized expenses incurred in seeking to acquire T’s stock (e.g., costs of diligence and seeking regulatory approvals) should produce ordinary deductions under generally applicable tax principles applying outside of §1234A, subject to a caveat noted in the following paragraphs.

(2) **P’s expenses in failed acquisition of T’s assets.** Where P incurs expenses in unsuccessfully pursuing an acquisition of T’s assets (rather than T’s stock), the same question arises regarding whether the general OL characterization (and OI characterization for a breakup or termination fee received by P) may be overridden by Code §1234A. However, Code §1234A applies only if P has acquired “a right or obligation . . . with respect to property which is (or on acquisition would be) a capital asset in the hands of” P. Business assets such as inventory and depreciable or amortizable assets are excluded from the capital asset definition and hence Code §1234A would not apply to any P right to acquire T assets of this type. Other T assets (e.g., debt instruments and corporate stock) would be capital assets in P’s hands. Accordingly, where P incurs expenses (or receives a breakup fee) in connection with its failed acquisition of T’s assets, the transaction would be bifurcated between
the portion of the transaction potentially subject to Code §1234A recharacterization and the portion of the transaction not subject to Code §1234A recharacterization.

(3) T’s expenses in P’s failed acquisition of T’s stock. Where T (i) incurs expenses in cooperating with or resisting P’s acquisition of T’s stock, (ii) the expenses are required to be capitalized under the §263 regulations, (iii) the transaction is not ultimately consummated, and (iv) continued capitalization is not required under certain doctrines discussed in the treatise, T’s expenses should generally produce an ordinary deduction under Code §165 or §162. Code §1234A should not apply to recharacterize such ordinary deduction as capital because T’s stock would not be a capital asset in T’s hands. Rather, in the hands of T, T stock is viewed for U.S. federal income tax purposes as extinguished. Likewise, if T receives a breakup or termination fee from P in connection with the termination of P’s proposed acquisition of T’s stock, that fee generally should be characterized as ordinary income as it is not received from the sale or exchange of a capital asset, nor should Code §1234A apply to provide capital characterization.

(4) T shareholder’s expenses in P’s failed acquisition of T’s stock. Code §1234A could apply to any T shareholder incurring costs (or realizing gain) in a proposed (but abandoned) acquisition by P of T’s stock. Code §1234A mandates capital gain or loss treatment for “gain or loss attributable to the cancellation, lapse, expiration, or other termination of . . . a right or obligation . . . with respect to property which is (or on acquisition would be) a capital asset in the hands of the taxpayer.” T stock is typically a capital asset in the hands of a T shareholder, so if the T shareholder is party to a legally binding agreement granting him rights or obligations with respect to P’s purchase of T’s stock (e.g., a stock purchase agreement between P and the T shareholder), Code §1234A would likely apply to any payment to the shareholder in connection with a termination of such agreement. In such case, it would be necessary to determine whether all or only some of the T shareholder’s capitalized costs in connection with the proposed stock sale should be included in the Code §1234A capital gain or loss calculation.

Code §1234A application is less clear where (i) the T shareholder incurs capitalized costs in connection with P’s proposed acquisition of T’s stock, (ii) P and T are parties to a merger agreement giving the parties rights and obligations with respect to T’s stock, but (iii) the T shareholder is not a party to the merger agreement and has no other direct agreement with P. In this fact pattern, we think that if the P-T merger agreement is terminated, the T shareholder should not be viewed as having a “right or obligation” with respect to the T stock the termination of which creates a loss, and hence the T shareholder should not be affected by Code §1234A. However, if the T shareholder is an individual, avoidance of Code §1234A may be a hollow victory because an individual’s non-capital loss is generally treated as a
miscellaneous itemized expense subject to deduction limitations for both regular tax and AMT purposes.

This topic is discussed and illustrated by numerous examples in ¶402.12.5 and ¶402.12.6.

**Substance-over-form doctrine.** The Sixth Circuit rejected IRS’s attempt to apply the “substance over form” doctrine to rearrange transaction steps in *Summa Holdings, Inc. v. Commissioner*. In that case, the shareholders of a closely held manufacturing corporation (Opco) formed Roth IRAs which, in turn, formed (through an intermediate corporation), a domestic international sales corporation (DISC). The Code permitted Opco to pay deductible commissions on export sales to the DISC without any requirement that the DISC perform services of equivalent value, and Opco did just that. The DISC then distributed dividends through the intermediate corporation to the Roth IRAs. Through this structure, substantial funds moved into the shareholders’ Roth IRAs without being subject to shareholder-level tax.

IRS argued that the actual cash flows—commission payments by Opco to the DISC, followed by dividends to intermediate corporation, followed by dividends to the Roth IRAs—should be disregarded and the cash flows recharacterized as dividends paid by Opco to the shareholders, which they then contributed to their Roth IRAs.

Although the Tax Court agreed with this recharacterization, the Sixth Circuit did not, stating: “When two potential options for structuring a transaction lead to the same end and the taxpayers choose the lower-tax path, the Commissioner claims the power to recharacterize the transactions as the higher-taxed equivalents. . . . [T]he Commissioner simply stipulates that the ‘real’ transaction is the higher-taxed one, and that the lower-taxed route, often the more complex of the two, is a mere ‘formality’ he can freely disregard. . . . The substance-over-form doctrine, it seems to us, makes sense only when it holds true to its roots—when the taxpayer’s formal characterization of a transaction fails to capture economic reality and would distort the meaning of the Code in the process. But who is to say that a low-tax means of achieving a legitimate business end is any less ‘substantive’ than the higher-taxed alternative?” See discussion in ¶608.3.2.

**Code §355 spin-offs.**

- **5-year trade or business—acquisition of partnership/LLC as business expansion.** In order for a distributing corporation (D) to make a tax-free distribution of stock of a controlled subsidiary (C) under Code §355, both D and C must have been engaged in an active trade or business for at least 5 years. In determining whether this test is met, (a) an active trade or business acquired within 5 years of a spin-off is treated as a qualifying 5-year business if the acquisition represents
an “expansion” of an existing D or C business, and (b) the business activities of a partnership are attributed to D or C where D or C owns a “significant interest” in the partnership (which includes a $33\frac{1}{3}$% or-greater membership interest).

A 2016 IRS letter ruling addresses the interaction of these rules. In the ruling, D (which had owned for more than 5 years a greater-than-$33\frac{1}{3}$% interest in an LLC engaged in the widget business) increased its interest in a second LLC (engaged in the widget business in a different state) from less than $\frac{1}{3}$ to more than $\frac{1}{3}$. IRS ruled that D’s increase in its interest in the second LLC constituted an expansion of the business attributed to D from the first LLC. See discussion in ¶1004.2.1.3.

- **Code §355 predecessor and successor.** Code §355(e) requires D to recognize gain on an otherwise tax-free spin-off of C’s stock if, pursuant to a plan existing on the distribution date, 50% or more of the voting power or value of the stock of D or C is acquired by a person or persons acting in concert. Code §355(e)(4)(D) states that a reference to D or C in Code §355(e) “shall include a reference to any predecessor or successor to such corporation.” For many years, the scope of this simple sentence was unclear. In 12/16, IRS issued temporary regulations (generally applicable to distributions occurring after 1/18/17) providing some welcome guidance.

The temporary regulations are intended to ensure that Code §355(e) applies to a distribution in the following two types of fact patterns:

- **Predecessor fact pattern:** As part of a Code §355(e) “plan,” either (x) some of the assets of a corporation other than D or C (the “predecessor”) are transferred through D to C or (y) D acquires some of C’s stock, in each case on a full or partial tax-free basis, and D’s distribution of C’s stock has the effect of causing a division of the assets of the predecessor (i.e., some of the predecessor’s assets remain with the predecessor or with D and other assets have been transferred to C).

  A corporation may be a “predecessor” regardless of the level of its relationship to D or C and regardless of whether it is combined with D or C (e.g., through merger) or remains in existence as a separate corporation.

- **Successor fact pattern:** There is a Code §355(e) planned acquisition of a 50%-or-greater interest in a “successor” of D or C. For this purpose, a successor is a corporation to which D or C transfers property in a Code §381 transaction (i.e., a tax-free asset reorganization under Code §368 or a Code §332 liquidation) after D’s distribution of C’s stock.
The much more complicated part of the regulations addresses the predecessor fact pattern. The temporary regulations provide a set of definitions and rules that determine whether a predecessor of D (a “POD”) exists, and, if so, whether the POD’s assets have been divided in connection with a Code §355 distribution and related ownership change in an impermissible manner, so that §355(e) taxation results.

The rules take into account transactions that occur pursuant to a “Plan,” as described in Code §355(e) and Reg. §1.355-7 (i.e., a plan involving both a distribution by D of C’s stock and an impermissible acquisition by a third party of a 50%-or-greater interest in D or C), for this purpose treating references to D or C as references to predecessors and successors of D or C. Then, in determining whether certain transactions between a potential predecessor corporation and D cause that other corporation to be treated as a POD, the rules focus on transactions that occur within a specific time frame, called the “Plan Period.” This is the period ending immediately after D’s distribution of C’s stock and beginning on the earliest date on which any pre-distribution step that is part of the plan is agreed to or understood, arranged, or substantially negotiated by D or C officers or directors, controlling shareholders, or by another person with the implicit or explicit permission of such persons.

The transactions during the Plan Period that matter are those where either (i) assets move in a tax-free manner from the predecessor to D and then from D to C in exchange for C stock that is then distributed under Code §355 or (ii) C stock moves in a tax-free manner from the predecessor to D and is then distributed under Code §355. Where such transactions occur, the predecessor corporation is treated as a POD if, immediately following D’s distributions of C’s stock, assets held directly or indirectly by the predecessor corporation during the Plan Period have been divided between C on the one hand and D or the predecessor corporation on the other hand.

Once a corporation has been identified as a POD, the level of any ownership change that occurs as part of a Plan must be tracked separately for D and each POD, as there could be a 50%-or-greater ownership change with respect to a POD but not with respect to D or vice versa. If there has been a planned acquisition of 50% or more of the POD (but not of D), D must recognize gain under Code §355(e), but limited to the amount of gain that would have been recognized if the “tainted” C stock D received either (i) from the predecessor or (ii) in exchange for assets D received from the predecessor had been distributed in a Code §355 distribution that violates Code §355(e).
Application of these intricate rules is best illustrated (and based on our reading can only be understood) through examples. The regulations are discussed and illustrated by examples in ¶1010.1.2.4.2.

- **Deductibility of interest—new restrictive Code §385 regulations.** Code §385 authorizes Treasury to issue regulations to determine whether an interest in a corporation should be treated as stock or debt for tax purposes and provides a list of factors that regulations may take into account in making this determination. In the early 1980s Treasury issued draft Code §385 regulations attempting to distinguish debt from equity, but withdrew the draft regulations before they ever took effect. Prior editions of this treatise expressed doubt that Treasury/IRS would make another attempt to attack the Code §385 tar baby in the foreseeable future. The unforeseen happened, however, in 2016 when IRS, driven by Obama administration concerns about erosion of the U.S. corporate tax base resulting from issuances of debt by U.S. subsidiary corporations to non-U.S. parent corporations, including in connection with “inversion” transactions, issued 4/16 proposed and 10/16 temporary and final regulations under Code §385.

Previous Treasury attempts to prescribe regulations under Code §385 sought to develop debt/equity characterization rules (applicable to all debt instruments) that were consistent with, but more objective than, the common law debt/equity rules. The 10/16 regulations take a very different approach. They apply to a limited set of debt instruments and are flatly inconsistent with the common law rules.

The 10/16 regulations mandate equity characterization for certain related-party debt instruments issued by U.S. corporations, without regard to the applicable instrument’s “debt” characteristics under the subjective common law debt/equity factors. IRS describes the regulations as focused on “factual situations where IRS has elevated concerns about related-party debt being used to create significant federal tax benefits without having meaningful non-tax effects” (including where issuance of the related-party debt instrument does not finance new investment in the issuer). Although the 10/16 regulations are significantly narrower in application than the heavily criticized 4/16 proposed regulations, it remains to be seen whether the 10/16 regulations will survive the Trump administration.

The 10/16 regulations first identify a set of debt instruments that are potentially subject to equity recharacterization (an “expanded group instrument” or “EGI”). The regulations then generally require equity recharacterization for all EGI (without regard to equity-like or debt-like characteristics) that are (1) issued in certain types of described transactions (the “transaction rules”) or (2) not supported by appropriate contemporaneous documentation (the “documentation rules”),
unless the EGI fits within a number of taxpayer-favorable exceptions from these general equity recharacterization rules.

**EGI definition.** The 10/16 regulations define an EGI as a debt instrument issued by a U.S. corporation to a member of the issuer’s “expanded group.” Subject to certain carve-outs and exceptions, an “expanded group” means a parent corporation (whether U.S. or non-U.S.) and each other corporation (whether U.S. or non-U.S.) in which the parent corporation directly or indirectly (including through partnerships) owns 80% or more of the other corporation’s stock by vote or value. Importantly, however, under this definition (and the regulatory carve-outs), the following types of debt instruments are *not* treated as EGIs and hence are not subject to equity recharacterization under the regulations:

- A debt instrument issued by a U.S. corporation to another U.S. corporation if both are members of the same consolidated group, unless and until either the issuer or holder of the instrument ceases to be a member of the consolidated group or the obligation is otherwise transferred outside of the consolidated group,
- A debt instrument issued by or to an S corp,
- A debt instrument issued by or to a REIT or RIC (unless 80% or more of the REIT or RIC is owned [directly or indirectly] by a C corp or by members of a single expanded group),
- A debt instrument issued by or to a partnership (unless 80% or more of the partnership is owned [directly or indirectly] by a C corp or members of a single expanded group), and
- A debt instrument issued between two corporations that are commonly owned by a partnership (unless 80% or more of the partnership is owned [directly or indirectly] by a C corp or members of a single expanded group).

An EGI may be recharacterized as equity by the 10/16 regulations under either of two separate sets of rules (i.e., the “transaction rules” or the “documentation rules”).

**Transaction rule recharacterization.** Under the “transaction rules” (generally applicable to any EGI issued on or after 4/5/16), an EGI is characterized as equity if the EGI is issued in a specified transaction that IRS has determined lacks (or is of a type that often lacks) a non-tax purpose. Specifically, subject to certain exceptions, the transaction rules characterize an EGI as equity if issued by one expanded group member to another in a “targeted transaction,” which means:

1. in a distribution (whether or not characterized as a dividend for tax purposes), or
2. in exchange for stock of an expanded group member, or
in exchange for property in an intercompany asset reorganization (as defined in Code §368) where, pursuant to the reorganization, an expanded group member receives the debt instrument with respect to its stock in the transferor.

Issuance of an EGI in exchange for cash or for property other than stock or assets of another expanded group member is not a “targeted transaction” (because not issued in a distribution, or in exchange for stock of an expanded group member, or in exchange for property in an intercompany asset reorganization), and hence, as a general matter, such an EGI is not subject to equity recharacterization under the transaction rule.

However, the 10/16 regulations do mandate equity recharacterization if such a “non-targeted” EGI is issued with “a principal purpose” of funding one or more targeted transactions (the “funding rule”). Such a principal purpose is deemed to exist (without regard to the parties’ actual intent) if the EGI is issued during the period beginning 36 months before and ending 36 months after any distribution or acquisition that is a targeted transaction. This deeming of malign purpose creates a significant trap for the unwary. Outside the 72-month window, a facts-and-circumstances analysis applies to determine whether an EGI is issued with a principal purpose of funding a targeted transaction. Multiple EGIs may be treated as funding a targeted transaction under the funding rule, and a single EGI may be treated as funding multiple targeted transactions.

As a taxpayer relief measure, the 10/16 regulations provide numerous exceptions to transaction rule equity recharacterization. Of those exceptions, the following four are the most significant:

1. **Threshold exception.** An EGI is not reclassified as equity under the transaction rules to the extent that, immediately after the EGI’s issuance, the aggregate adjusted issue price of EGIs held by expanded group members that would be subject to equity reclassification under the transaction rule in the absence of this exception (or any other exception or exemption to transaction rule equity reclassification) does not exceed $50 million. If the $50 million threshold is exceeded, generally only the excess amount of EGIs is reclassified as equity under the transaction rules.

2. **Expanded group earnings account.** The aggregate amount of targeted transactions made by an expanded group member that would otherwise be subject to the transaction rules is generally reduced by that member’s current year and accumulated earnings and profits accumulated while the member has been part of the expanded group (subject to certain exclusions), with targeted transactions being reduced under this exception based on the chronological order in which they occur.

3. **Qualified contributions.** The aggregate amount of targeted transactions made by an expanded group member that would otherwise be subject to the transaction rules is
reduced by certain capital contributions made by other expanded group members to the member over a period of time that can begin up to 36 months prior to the issuance of an EGI and that can end up to 36 months after the issuance of an EGI.

(4) **Short-term debt instruments and certain cash pooling arrangements.** Under complicated rules, generally excepted from the transaction rules are (i) certain EGIs issued to fund ordinary course capital requirements at arm’s-length interest rates, (ii) certain EGIs with a term not exceeding 270 days and an arm’s-length interest rate, (iii) certain EGIs with no interest payments (either actual or deemed under other U.S. federal income tax rules), and (iv) customary cash pooling arrangements that satisfy certain requirements.

**Documentation rule recharacterization.** The documentation rules (generally effective for an EGI issued on or after 1/1/18) apply only if the issuer is a member of an expanded group (i) any member of which expanded group is publicly traded or (ii) which expanded group owns assets with an FV exceeding $100 million or has total annual revenue exceeding $50 million.

Under the documentation rules, an EGI will be respected as debt only if documentation with respect to the debt instrument establishes:

1. an unconditional and binding obligation to repay the funds,
2. creditor’s rights of the holder to enforce the terms of the EGI,
3. a “reasonable expectation” of the issuer’s ability to repay the EGI in accordance with its terms, as of the date of issuance of the debt instrument, and
4. that the actions of the holder and issuer of the EGI evidence a debtor-creditor relationship with respect to the EGI.

This documentation requirement generally must be satisfied by the time the issuer files its federal income tax return for the year in which the EGI was issued and must continue to be satisfied during the life of the debt instrument (or, if earlier, until the instrument ceases to be an EGI). If the documentation rules are not satisfied and certain reasonable cause exceptions are not available to avoid equity classification, then an EGI is generally classified as equity from the later of (i) the date that it was issued and (ii) the date that it became an EGI. Consequently, failure to satisfy ongoing documentation requirements with respect to a debt instrument can retroactively reclassify an instrument as equity and, potentially, trigger a material liability with respect to disallowed interest deductions.

The Code §385 regulations are discussed, and illustrated by numerous examples, in ¶1302.2.
New GAAP accounting rules for executive stock- or option-based compensation can result in increased GAAP net income for employer. Under revised 3/16 GAAP rules, in the case of Newco’s stock sale or award to an executive, Newco’s accounting compensation expense (which reduces Newco’s accounting net income) is equal to the stock FV at the time of the sale or award less the price (if any) paid by the executive, while Newco’s accounting tax expense (which also reduces Newco’s accounting net income) is reduced (thus increasing Newco’s accounting net income) by Newco’s tax saving (calculated over the life of the award) resulting from its tax deduction on account of the stock sale or award.

Under the 3/16 revised GAAP rules, in the case of a stock option granted to an executive, Newco’s accounting compensation expense (which reduces Newco’s accounting net income) is equal to the option FV at the grant date, taking into account both (1) the spread (if any) at grant and (2) the FV of the option privilege, i.e., the value to an executive from deferring the purchase decision and payment of the option price, while Newco’s accounting tax expense (which also reduces Newco’s accounting net income) is reduced (thus increasing Newco’s accounting net income) by Newco’s tax saving (calculated over the life of the award) resulting from its tax deduction on account of the stock option grant and exercise.

For a stock sale or award or a stock option, the revised GAAP rules measure accounting compensation expense at grant date, but tax consequences at tax recognition date based on Newco’s actual ultimate tax results. Thus, if stock FV rises between grant and tax recognition date (i.e., generally for a stock grant or sale, immediately if there is no SRF or if there is an SRF with a §83(b) election, or at vesting where there is an SRF and no §83(b) election, and for an option, at exercise if there is no post-exercise SRF or there is an §83(b) election at exercise), Newco would generally recognize an increase in its tax benefits and hence in its accounting income.

Thus, the 3/16 GAAP rules—taking into account (in Newco’s accounting income statement) Newco’s actual tax benefits from deducting stock- or option-based compensation—may lead to greater volatility in Newco’s accounting net income (than would have resulted from prior GAAP rules), e.g., a substantial increase in Newco’s stock price may result in a substantial decrease in Newco’s taxes and hence a substantial increase in Newco’s accounting net income.

Indeed, after adopting the 3/16 GAAP rules, several high-tech companies have reported large increases to their accounting net income attributable to tax benefits flowing from the exercise of employee stock options. See discussion at ¶1502.3.1.2 (which contains examples based on several alternative grant and vesting/exercise scenarios).

Delaware fiduciary duty rules for partnership’s GP. Delaware partnership and LLC law gives a partnership or LLC substantial leeway to contract or expand (by clear
provisions in the entity’s basic agreement) the GP’s (or managing member’s) fiduciary duty with respect to transactions between the entity and the GP (or managing member).

Accordingly, the Delaware courts have held that a GP’s compliance with a conclusive-presumption-of-good-faith clause in a partnership agreement—i.e., a provision stating that the GP’s reliance on an independent adviser’s opinion or an independent committee’s decision or some other specified act conclusively demonstrates good faith—as a prerequisite for entering into a conflicted transaction (i.e., a transaction which will benefit the GP or its affiliates) protects the GP from a breach of contractual fiduciary duty claim.

However, a 2013 Delaware Supreme Court opinion (reversing the Delaware Chancery Court) concluded that GP’s reliance on such a specified act does not prevent GP’s action from breaching Delaware’s statutory non-waivable implied duty of good faith and fair dealing. The court:

(i) stated that good faith in the “contractual fiduciary duty [context is] . . . very different from the good faith concept addressed by [Delaware’s] . . . implied covenant” of good faith and fair dealing, so the “two distinct concepts” should not be “conflated” and

(ii) as examples stated that obtaining a fairness opinion based on “intentionally concealed material information” or “outright bribes” would “frustrat[e] the fruits of the bargain that the [LPs] . . . reasonably expected,” and hence would support a claim under the non-waivable implied duty because “had the parties addressed the issue at the time of contracting, they would have agreed that any [such] fairness opinion” would not conclusively demonstrate good faith.

In 2017 the Delaware Supreme Court reached a similar conclusion where publicly traded partnership T merged into related partnership P (i.e., T’s and P’s GPs were affiliates of each other), with the amount of stock and cash consideration paid by P to T’s LPs having been approved by:

(i) an allegedly independent (as defined in the 1934 Act and NYSE audit committee independence rules) conflicts advisory committee and

(ii) a majority of T’s LPs who were not affiliated with T’s GP,
both of which methods of approval T’s partnership agreement stated were sufficient to immunize the related-party merger from LP challenge.

However, proxy material prepared by T’s GP in connection with the LP vote failed to disclose that a member of T’s “independent” conflicts advisory committee had held a position with a P affiliate until four days after his appointment to the T
independent committee and had been reappointed to such position with the P affiliate immediately after closing of the T-into-P merger.

The court concluded that although T’s partnership agreement both disclaimed fiduciary duties and extinguished disclosure duties, once the GP voluntarily sent proxy material to the LPs, “we find that implied in the language of the LP Agreement’s conflict resolution provision is a requirement that the General Partner not act to undermine the protections afforded” LPs in voting on the transaction, notwithstanding that “the express terms of the LP Agreement did not address, one way or another, whether the General Partner could use false or misleading statements to enable it to reach the safe harbors.”

Such “terms are easily implied because the parties must have intended them and have only failed to express them because they are too obvious to need expression. . . . [O]nce [the GP] went beyond the minimal disclosure requirements of the LP Agreement, . . . implied in the language of the LP Agreement’s conflict resolution provision was an obligation not to mislead [LPs].” Also “[i]mplicit in the express terms is that the Special Committee membership be genuinely comprised of qualified members and that deceptive conduct not be used to create [a] . . . false appearance.” See discussion at ¶1602.3(6).

- **Double-tax penalty on REIT built-in gain reduced from 10 years to 5 years.** A C corp (with appreciated assets) electing to be taxed as a REIT (or an existing REIT acquiring appreciated assets from a C corp with carryover basis [“COB”]) is generally, by virtue of Code §337(d) and the regulations thereunder, subject to Code §1374’s entity-level corporate penalty tax on such built-in gain (“BIG”) to the extent such gain is recognized within a specified period (the “recognition period”) following the C corp’s REIT election (or the REIT’s COB asset acquisition from a C corp).

  Prior to 2016, the “recognition period” for a former C corp (with appreciated assets) electing to be taxed as a REIT (or for a REIT acquiring appreciated COB assets from a C corp) tracked the Code §1374 “recognition period” for a C corp electing to be taxed as an S corp (or an S corp acquiring COB appreciated assets from a C corp), i.e., 10 years for such gain recognized before 2009, temporarily reduced to 7 years for such gain recognized in 2009 and 2010, then temporarily reduced to 5 years for such gain recognized in 2011 through 2014, then permanently reduced to 5 years for gain recognized in 2015 and thereafter.

  While the length of an S corp “recognition period” (10 years, then 7 years, then 5 years) is established by statute (Code §1374), the length of the REIT recognition period has always been established by regulations, which until 6/16 simply incorporated by reference the S corp Code §1374 statutory recognition period. Indeed, the legislative history of the 12/15 legislation which made permanent the S-corp §1374 5-year
recognition period acknowledged that “Under current Treasury regulations, these [Code §1374] rules, including the five-year recognition period, also would apply to REITs” (emphasis added).

However, in 6/16 IRS surprisingly changed course, publishing temporary §337 regulations that, effective for a C corp with appreciated assets which converted to a REIT after 8/7/16 (or a REIT acquiring appreciated COB assets from a C corp after 8/7/16), de-linked the regulatory REIT recognition period from the statutory S corp recognition period, stating in the regulatory preamble that REIT conversions “will no longer be affected by [the shortening of] the length of the [S corp] recognition period from 10 years to 5 years with respect to C corporations that elect to be, or transfer property to, S corporations.” Instead, these temporary regulations adopted a 10-year recognition period for a C corp with appreciated assets which elected to be taxed as a REIT after 8/7/16 (or a REIT which acquired appreciated COB assets from a C corp after 8/7/16).

On 10/18/16 the Chairmen and Ranking Members of the House Ways and Means Committee and the Senate Finance Committee sent a letter to the Treasury Secretary, stating that the 10-year recognition period for a REIT was “inconsistent with congressional intent and longstanding practice that REITs, RICs and S corporations be subject to the same built-in gain recognition period.” The letter requested that the temporary regulations be revised to impose the same 5-year recognition period on a REIT that applies to a RIC or an S corp. IRS then reversed course on 1/18/17, issuing final regulations clarifying that the 5-year S corp recognition period also applies to REITs (effective for a conversion transaction occurring after 2/17/17).  

1 See discussion at ¶1607.1.

• Minority shareholder protective devices when T is being sold. When T is being sold and some of its shareholders object to the terms of such sale, state corporation law often grants T’s shareholders one or more protective devices, which can include:

  (a) dissenters’ rights of appraisal,
  
  (b) shareholder vote, and
  
  (c) minority shareholder class action suit asserting that T’s board of directors in selling T did not satisfy the “business judgment rule,” as supplemented (at least

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1Although a 10-year recognition period technically still applies to a C corp with appreciated assets which elected to be taxed as a REIT on or after 8/8/16 and on or before 2/17/17 (or to a REIT which acquired appreciated COB assets from a C corp on or after 8/8/16 and on or before 2/17/17), the final regulations allow such a REIT to elect a 5-year recognition period, and most can be expected to do so.
for a Delaware corporation) by (i) the “enhanced scrutiny” standard requiring
the board to obtain the highest price reasonably attainable for T’s shares
in a sale of T’s control where cash is all or a substantial portion of the
consideration or (ii) the “entire fairness” standard for a controlling shareholder
“conflicted transaction,”
as further described below.

- Dissenters’ rights of appraisal.
  
  ▲ Sale of T corp assets. If P is acquiring substantially all T’s assets, the laws
  of many jurisdictions permit a dissenting T shareholder to receive from
  P in cash the appraised FV of his T stock, as determined by a court.

  Delaware and some other states, however, deny appraisal rights to a T
  shareholder when T sells all or substantially all its assets unless T’s charter
  otherwise provides.

  ▲ Sale of T corp by merger. If P is acquiring T by merger, the laws of most
  jurisdictions allow a dissenting T shareholder to receive from P in cash the
  appraised FV of her shares, as determined by a court, although various state
  laws contain exceptions.

  Delaware, for example, denies appraisal rights to a T shareholder—whether
  P’s acquisition of T is accomplished by (1) two-party merger (T into P) or
  (2) three-party forward merger (T into P’s subsidiary S) or (3) three-party
  reverse subsidiary merger (P’s subsidiary S into T)—if 100% of the
  consideration to T’s shareholders (other than cash for fractional T shares) is
  comprised of P stock listed on a national securities exchange or held by more
  than 2,000 holders.

  However, if any part of the consideration to a T shareholder (other than
  cash for fractional T shares) consists of cash or property other than such listed
  or widely held T shares, such T shareholder is entitled to appraisal rights.

  Nevertheless, even where the above rules would have granted appraisal rights
  to a T shareholder, a 2016 Delaware statutory amendment denies such appraisal
  rights if the T shares seeking appraisal are listed on a national securities
  exchange and either:

  (a) the total number of T shares seeking appraisal does not exceed 1% of
      T’s outstanding shares of such class eligible for appraisal rights or

  (b) the FV of the consideration (provided in the merger agreement) for all
      the T shares seeking appraisal does not exceed $1 million,
but nonetheless does allow appraisal rights (notwithstanding (a) and (b) above) if the merger is a short-form merger, i.e., a merger not requiring T shareholder approval because P already owned at least 90% of T’s shares at the time of the T-into-P merger. See discussion at ¶1702.7.

- Shareholder vote.

  ▲ Sale of T corp assets. If P acquires all or substantially all of T’s assets, state law generally requires T shareholder approval, with the necessary percentage for approval varying according to the law of T’s jurisdiction of incorporation and the specific provisions of T’s charter (which may require a higher percentage than applicable state law).

  In Delaware, for example, a sale of all or substantially all of T’s assets requires approval of a majority of T’s outstanding voting stock, unless T’s charter calls for a higher percentage. Many other states require more than a majority (frequently two-thirds) for approval.

  States differ in their interpretation of “substantially all” of a corporation’s assets, with some cases indicating that over 50% may be “substantially all,” or in some cases even less than 50%.

  ▲ Sale of T corp by merger. A merger generally requires approval from T’s shareholders with the required percentage varying from state to state, subject to increase by a corporation’s charter.

  In Delaware, for example, a merger requires approval from a majority of T’s outstanding voting stock, unless its charter calls for a higher percentage. Many other states require more than a majority (frequently two-thirds) for approval.

  However, where P has first purchased a portion of T’s stock—in a tender offer and/or one or more negotiated purchases—and P then desires to squeeze out T’s remaining (minority) shareholders by merger, there are two circumstances where a vote of T’s shareholders can be avoided:

  First, most state laws contain an exemption allowing a short-form merger—without any T shareholder vote—between P and one of its subsidiaries (here T)—with T’s minority shareholders receiving P stock, cash, or other consideration as specified in the short-form-merger agreement. The percentage ownership that P must have in T in order to utilize the short-form merger procedure (without a T shareholder vote) varies from state to state (90% being the necessary percentage in Delaware).
Second, a 2013 addition to Delaware law (as further amended in 2016) allows a vote of T’s shareholders on a merger between T and P to be avoided where:

(a) T corp has more than 2,000 shareholders or is listed on a national securities exchange immediately prior to executing the merger agreement,

(b) P or its subsidiary (“AcquiringCorp”) makes a first-step tender or exchange offer for any and all T stock,

(c) immediately following consummation of the tender offer, the T stock purchased by AcquiringCorp in such tender offer, together with the T stock otherwise owned by AcquiringCorp and any rollover stock (as defined below), is sufficient to approve the second-step squeeze-out merger (under Delaware law and T’s charter), generally more than 50%,

(d) all non-tendered T stock (other than rollover stock) is exchanged in the second-step squeeze-out merger for the same amount and kind of consideration per share as was received by the tendering T shareholders in the tender offer (i.e., cash in the same amount per share as in the tender offer where the tender offer consideration was cash), and

(e) T is incorporated in Delaware.

“Rollover stock” means T shares covered by a written agreement requiring such shares to be transferred to AcquiringCorp in exchange for AcquiringCorp stock, so long as such T shares have actually been transferred to AcquiringCorp no later than immediately prior to the time the merger becomes effective.

Before the 2016 Delaware statutory amendment, all non-tendering T shareholders were required to receive (in the squeeze-out merger) the same type and amount of consideration per share for their T stock as the tendering T shareholders (i.e., requirement (d) above but without the parenthetical exception for rollover stock which was added by the 2016 amendment). However, after the 2016 amendment, AcquiringCorp can now acquire T shares owned by one or more T shareholders (including T executives) in exchange for AcquiringCorp stock, even though all of T’s other shareholders receive cash for their T shares (both in the tender offer and in the squeeze-out merger).

While the 2016 statutory amendment allows T stock owned by any T shareholder (not merely by a T executive) to be treated as rollover stock, i.e., acquired by AcquiringCorp in exchange for AcquiringCorp stock, the provision is most likely to be used in practice only to roll one or more key T executives’ T stock into AcquiringCorp stock.
Especially where P is a new entity (formed by a PE fund to acquire T in an LBO), P may (after the 2016 amendment) offer T executives (who will post-merger become key P executives) an opportunity to exchange their T shares for P shares tax-free (as part of P's Code §351 formation and buyout of T), thus allowing such T executives to exchange their low tax basis T stock without CG recognition for higher FV P stock (which takes a post-merger low carryover tax basis from their old T stock). See discussion at ¶1702.8.1 through ¶1702.8.3.

- **T board’s fiduciary duty.**

  (1) **Business judgment rule.** Under state corporate law, business judgments reached by T corporation’s directors are generally respected and accorded deference if the board acted on an informed basis, in good faith, and in the honest belief that the action was taken in the best interests of the corporation and its shareholders. In order for the board to claim the benefit of this judicial “business judgment rule,” the board must be able to demonstrate that it acted with due care after thorough study and conscientious deliberation.\(^2\)

  (2) **Revlon enhanced scrutiny.** However, under Delaware law, when T corp’s board is considering a transaction in which T’s shareholders give up T’s control—i.e., (i) a sale of T where cash is all or a substantial portion of the consideration (e.g., PE fund sponsors Newco’s LBO acquisition of T or P acquires T with cash comprising all or a substantial portion of the consideration) or (ii) a combination of T and P with T’s shareholders receiving P stock but with the combined P-T enterprise thereafter controlled by one P shareholder (or by a group of P shareholders acting in concert)—T’s directors have a duty more rigorous than required by the business judgment rule to protect the interests of T’s shareholders and obtain the highest price for their shares reasonably attainable (the so-called Revlon duty), so courts typically subject the directors’ conduct to “enhanced scrutiny” to ensure that they have acted reasonably to achieve these goals.

  Enhanced scrutiny involves a judicial determination as to (i) the adequacy of the decision-making process employed by T’s directors, including the information on which they based their decision to pursue the transaction, (ii) the reasonableness of T directors’ actions in light of the circumstances then existing, and (iii) the ability of T’s board to accept higher offers even after a definitive agreement for the transaction has been signed. There is no one path to satisfying T directors’ Revlon duty and, depending on circumstances, courts have been satisfied with:

\(^{2}\)While Delaware law is clear on the board’s fiduciary duty issues discussed in text and some other states’ law is less clear, most states are likely to agree on the principles herein enunciated, subject to the “other-constituency” statutes enacted by some states, as discussed in (5) below.
(a) a full “market check” where T or its financial advisers solicit interest from a wide array of potential bidders for T before signing a merger agreement with P,

(b) a limited market check where T or its financial advisers solicit pre-signing interest from a small number of the most likely competing bidders,

(c) either some or perhaps even no pre-signing market check by T, so long as the signed P-T acquisition agreement allows competing bidders for T to submit unsolicited alternative offers after signing the P-T acquisition agreement (but before T shareholder approval) and also allows T directors to terminate the P-T acquisition agreement after paying P a reasonable termination fee, if the T directors believe such an unsolicited alternative offer is superior to the terms offered by P, and/or

(d) no pre-signing market check by T, so long as the signed P-T acquisition agreement allows T and its financial advisers to actively solicit offers from select alternative bidders for a short post-signing period (a “go-shop”) and also allows T directors to terminate the P-T acquisition agreement, after paying P a reasonable termination fee (typically smaller than the fee described in (c) since T will not have conducted any market check, so the hurdle for a superior bidder is lower than in (c)) if T’s directors believe such an alternative offer is superior to the terms offered by P.

When some board members have an interest in the transaction different from the interest of T’s shareholders generally—e.g., in an LBO where Newco or its PE fund sponsor offers T’s management the opportunity to continue as post-acquisition Newco/T executives, perhaps with increased compensation, and/or to invest in Newco by buying, or receiving options to buy, Newco common stock—it is advisable to form a committee of T independent directors (composed of T directors with no interest in the acquirer) to foster an arm’s-length negotiation between the acquirer and T, and often to engage in an auction process or limited market check with the assistance of an independent investment banker.

Where the enhanced scrutiny standard is not met and a Delaware court concludes that T’s disinterested directors did not thoroughly review the proposed sale of T (and alternative opportunities) and take reasonable steps necessary to maximize T shareholders’ sale proceeds, Delaware courts have enjoined P’s acquisition of T, or if the acquisition has already been consummated, have held T directors personally liable for breaching their fiduciary duty by selling T for too low a price.

(3) Exception to enhanced scrutiny, allowing business judgment rule to apply. Delaware courts have, however, held that the enhanced scrutiny standard does not
apply to a transaction otherwise falling within the parameters for enhanced scrutiny (as described in (2) above) where:

(i) the transaction has been approved by a fully informed, uncoerced majority vote of disinterested T shareholders (or by such a majority of T’s fully informed, uncoerced, disinterested shareholders tendering their T stock to P, which is viewed as the equivalent of a majority shareholder vote), and

(ii) the P-T transaction has already been consummated so the issue before the court is damages (not an injunction), and

(iii) the transaction is not covered by the more rigorous “entire fairness” standard applicable where T is engaging in a “conflicted transaction” with its controlling shareholder (as discussed in (4) below).

(4) Controlling shareholder conflicted transaction. Where T has a controlling shareholder (the “T controller”) and P’s acquisition of T is a “conflicted transaction,” Delaware courts have adopted an “entire fairness” standard of review (which is even more rigorous than the “enhanced scrutiny” standard described in (2) above).

One type of conflicted transaction is where the T controller seeks to acquire the remaining T shares not previously held by the T controller. In such case Delaware courts apply an “entire fairness” standard, requiring proof that both price and process have been fair (almost always requiring a full trial if a minority shareholder sues), unless the following six-part test is satisfied:

(a) from the outset the T controller conditioned the transaction on non-waivable approval of both (i) a T board independent committee and (ii) a majority-of-the-minority shareholders,

(b) the independent committee is independent of the T controller,

(c) the independent committee is empowered to freely select its own legal and financial advisers and to definitively reject the T controller’s offer,

(d) the independent committee meets its duty of care in negotiating a fair price for the minority shareholders,

(e) the minority shareholders are fully informed, and

(f) the minority shareholder approval is uncoerced.

This Delaware six-part test is also employed in a second type of conflicted transaction where the T controller is selling T to an independent third party (P), but the T controller receives some benefit that the T minority shareholders do not receive (a “differential transaction”), which could include (i) a higher price per T
share than the T minority shareholders are receiving, or (ii) P shares in exchange for part or all of the T controller’s shares while the T minority shares are receiving cash, or (c) satisfaction of an extreme liquidity need on the part of the T controller (not shared by the T minority shareholders). In such a differential transaction, the T controller is permitted to receive such a benefit without requiring entire fairness, i.e., that both price and process have been fair, so long as the six-part test discussed above is satisfied.

Entire fairness is not implicated solely because T has a controlling shareholder, but only where T has a controlling shareholder and P’s acquisition of T is a conflicted transaction (as described above). Thus, where the T controller sells its entire stake in T, receiving identical consideration per share to the minority shareholders, the business judgment rule (not the entire fairness standard) applies (supplemented by enhanced scrutiny in a sale of T’s control where cash is all or a substantial portion of the consideration or the combined P-T enterprise is controlled by one P shareholder or a group of P shareholders acting in concert), unless the controller forced an inappropriate T fire sale in order to solve the controller’s personal liquidity crisis.

(5) Other constituency statutes. Approximately 30 states (but not Delaware) have enacted various versions of “other-constituency” statutes, permitting (or in a few cases requiring) T’s board of directors, in acting on P’s proposed acquisition of T, to consider interests other than those of T’s shareholders. Various of these statutes permit or require the board to consider the interests of:

- T’s employees,
- T’s customers,
- T’s creditors,
- T’s suppliers,
- communities served by T,
- T’s long-term interests,
- the local and national economy,
- P’s reputation, ability, and potential conduct,
- other factors T’s board deems pertinent, and
- the possibility that T’s continued independence may best serve T’s long-term interests.

Some of these other-constituency state statutes apply to any acquisition of T, while some apply only to certain forms of acquisition, e.g., a sale of all or substantially all T’s assets.
There is little precedent on the extent to which a court may hold that such a permissive or mandatory other-constituency statute exonerates T’s board from liability (or injunction) where T’s board has not engaged in the activities which would have been required to satisfy the board’s fiduciary duty had an other-constituency statute not been in effect, i.e., because T’s board accepted an acquisition proposal that did not provide T’s shareholders with the highest price reasonably attainable for T’s shares. See discussion at ¶1702.9.

- **Reg. D issuance of unregistered securities in private placement.** Reg. D Rule 506(b) allows an issuer to issue its stock in a private placement (without 1933 Act registration) where all purchasers are accredited investors (plus up to 35 sophisticated non-accredited investors), with whom the issuer has a pre-existing substantive relationship (with less intrusive investor self-verification), so long as the issuer does not engage in general solicitation or advertising.

  Rule 506(c), on the other hand, allows the issuer to issue its stock in a private placement (without 1933 Act registration) where all purchasers are accredited investors (i.e., none are non-accredited investors), even where the issuer does not have a pre-existing substantive relationship with such purchasers and even where the issuer does engage in general solicitation and advertising (so long as the issuer engages in more burdensome enhanced accredited investor verification).

  An issuer who makes two related securities offerings—first a purported Rule 506(c) offering with 100% accredited purchasers utilizing general solicitation or advertising followed by a second purported Rule 506(b) offering with at least one non-accredited purchaser not utilizing general solicitation or advertising—cannot (absent an adequate cooling off period as discussed below):

  (i) use Rule 506(c) (with general solicitation or advertising) for the first 100%-accredited-purchaser offering because there is at least one non-accredited purchaser in the subsequent purported Rule 506(b) integrated offering nor

  (ii) use Rule 506(b) for the second offering with at least one non-accredited purchaser because there is general solicitation or advertising in the integrated offering.

  SEC’s subjective integration doctrine would likely be employed to determine whether the later purported Rule 506(b) offering is integrated with (and thus tainted by) the earlier purported Rule 506(c) offering, unless the sequence of offerings satisfied SEC’s 6-month-objective-safe-harbor exception.

  However, where the two Rule 506 offerings are reversed, so that the purported Rule 506(b) offering (utilizing no general solicitation or advertising) precedes the purported Rule 506(c) offering (to 100% accredited investors), SEC in 2016 issued a non-integration interpretation, dealing with an issuer who conducted a Rule 506(b) private
offering, but then, within 6 months after the most recent 506(b) sale, conducted a Rule 506(c) offering with general solicitation or advertising, and SEC concluded that “offers and sales . . . in reliance on Rule 506(b) prior to the general solicitation would not be integrated with subsequent offers and sales . . . pursuant to Rule 506(c),” without SEC requiring any particular cooling-off period. See discussion at ¶1702.11.2.3.

- **HSR filing for acquisition.** A Hart-Scott Rodino (“HSR”) filing with FTC/DOJ is required if the size of an acquisition or investment (and, in certain cases, the size of the parties to the transaction) exceeds specified numerical tests.

  - **Annual inflation adjustment.** The authors have updated the HSR discussion to reflect the 2/17 annual inflation adjustment of all the relevant HSR tests, thresholds, and filing fees. See discussion at ¶1707.

  - **Non-compliance penalty.** Effective 1/24/17, the maximum civil penalty for an HSR violation increased to $40,654 per day. See discussion at ¶1707.6.

- . . . and much, much more.