# MERGERS AND ACQUISITIONS

It’s All About Due Diligence

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- Antitrust Laws:
- Antitrust laws are regulations that encourage competition by limiting the market power of any particular firm. This often involves ensuring that mergers and acquisitions don’t overly concentrate market power or form monopolies, as well as breaking up firms that have become monopolies.

## Antitrust Law (Cont.)

- Antitrust laws were designed to protect and promote competition within all sectors of the economy.
- **The Sherman Act**, the **Federal Trade Commission Act**, and the **Clayton Act** are the three pivotal laws in the history of antitrust regulation.
- Today, the Federal Trade Commission , sometimes in conjunction with the U.S. Department of Justice, is tasked with enforcing federal antitrust laws.

**Department of Justice "DOJ"**: the DOJ provides legal services to the National Government and its functionaries, including government-owned and controlled corporations and their subsidiaries, to ensure that all actions are within the context of the Rule of Law.

**Federal Trade Commission "FTC":** The FTC enforces federal consumer protection laws that prevent fraud, deception and unfair business practices. The Commission also enforces federal antitrust laws that prohibit anticompetitive mergers and other business practices that could lead to higher prices, fewer choices, or less innovation.

# DOJ and FTC what do they do?

| | |
|---|---|
| The DOJ goes after both international and national companies and the FTC monitors trade between international and national companies. | 0% |
| The DOJ provides states and the national government with legal services and the FTC provides only the national government with enforcement of trade and commercial activities. | 0% |
| The DOJ is the U.S's law firm. It provides legal services to the national government and makes sure that all actions comply with the rule of law. The FTC enforces federal consumer protection laws that prevent fraud and deception and unfair business practices. | 0% |

# DOJ and FTC what do they do?

The DOJ goes after both international and national companies and the FTC monitors trade between international and national companies. — 0%

The DOJ provides states and the national government with legal services and the FTC provides only the national — 50%

The DOJ is the U.S's law firm. It provides legal services to the national government and makes sure that all … raud and deception and unfair business practices. — 50%

- **Sherman Anti-trust Act:**
- Approved July 2, 1890, The Sherman Anti-Trust Act was the first Federal act that outlawed monopolistic business practices.
  - The Sherman Antitrust Act is a law the U.S. Congress passed to prohibit trusts, monopolies, and cartels.
  - Its purpose was to promote economic fairness and competitiveness and to regulate interstate commerce.
  - The act signaled an important shift in American regulatory strategy toward business and markets.

## Sherman Act (Cont.)

- It also outlawed contracts, conspiracies, and other business practices that restrained trade and created monopolies within industries.

- The Sherman Act was amended by the Clayton Antitrust Act in 1914, which addressed specific practices that the Sherman Act did not ban.

- **Federal Trade Commission Act of 1914**
- The Federal Trade Commission Act of 1914 is a United States federal law which established the Federal Trade Commission. The Act was signed into law by US President Woodrow Wilson in 1914 and outlaws unfair methods of competition and unfair acts or practices that affect commerce.

- **Clayton Antitrust Act**
- The Clayton Antitrust Act is a piece of legislation passed by the U.S. Congress and signed into law in 1914, that defines unethical business practices, such as price fixing and monopolies, and upholds various rights of labor.
- Price Fixing: an agreement (written, verbal, or inferred from conduct) among competitors to raise, lower, maintain, or stabilize prices or price levels .

## Clayton Antitrust Act (Cont.)

- The Clayton Antitrust Act of 1914 continues to regulate U.S. business practices today.
- Intended to strengthen earlier antitrust legislation. The act prohibits anti-competitive mergers, predatory and discriminatory pricing, and other forms of unethical corporate behavior.
- The act also protects individuals by allowing lawsuits against companies and upholding the rights of labor to organize and protest peacefully.
- The law is jointly enforced by the FTC and DOJ.

# Which was the first anti-trust legislation?

| | |
|---|---|
| The Federal Trade Commission Act | 0% |
| The Clayton Act | 0% |
| The Sherman Act | 0% |

9

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Showing Results

# Which was the first anti-trust legislation?

- **Mergers and Acquisitions:** The Clayton Act gives the FTC the authority to review mergers and acquisitions. This is done to decide whether the merger or acquisition would substantially lessen competition or create a monopoly. If the FTC determines that a merger or acquisition would have anti-competitive effects, the FTC can disallow the companies from combining.

- **What Is a Merger?**
- A merger is an agreement that unites two existing companies into one new company. There are several types of mergers and also several reasons why companies complete mergers. A+B=C
- Mergers and Acquisitions (M&A) are commonly done to expand a company’s reach, expand into new segments, or gain market share. All of these are done to increase shareholder value. Often, during a merger, companies have a no-shop clause to prevent purchases or mergers by additional companies.

- Mergers (Cont.)

  - The five major types of mergers are:
  - **Conglomerate**
  - **Congeneric**
  - **Market Extension**
  - **Horizontal**
  - **Vertical**

- **Conglomerate Merger**

- This is a merger between two or more companies engaged in unrelated business activities. The firms may operate in different industries or in different geographical regions.

Companies with no overlapping factors will only merge if it makes sense from a shareholder wealth perspective, that is, if the companies can create synergy, which includes enhancing value, performance, and cost savings.

Example: Walt Disney Company and American Broadcasting Company

## Congeneric Merger

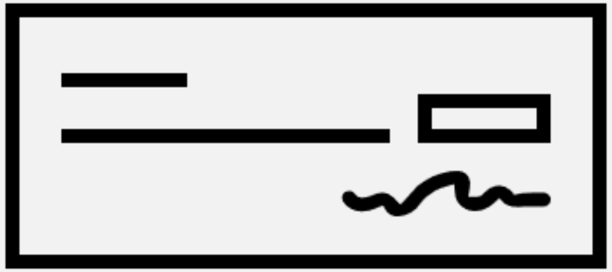
A congeneric merger is also known as a Product Extension merger. In this type, it is a combining of two or more companies that operate in the same market or sector with overlapping factors, such as technology, marketing, production processes, and research and development (R&D).

A Product Extension Merger is achieved when a new product line from one company is added to an existing product line of the other company.

- **Congeneric Merger (Cont.)**

- **Ex. I sell insurance to space travelers. I merge with another insurance company that sells car insurance, health insurance, homeowners' insurance, etc.**

- When two companies become one under a product extension, they are able to gain access to a larger group of consumers and, thus, a larger market share.



- **Market Extension Merger:**

- This type of merger occurs between companies that sell the same products but compete in different markets. Companies that engage in a market extension merger seek to gain access to a bigger market and, thus, a bigger client base.

- **Example**: **JLM Bank has a large presence in the Southern Part of the U.S. but not the Northeast. It merges with NOP, a bank in the Northeast, to gain access to a bigger market**.

# Horizontal Merger

A horizontal merger occurs between companies operating in the same industry. The merger is typically consolidation between two or more competitors offering the same products or services. Such mergers are common in industries with fewer firms, and the goal is to create a larger business with greater market share and <u>economies of scale.</u> since competition among fewer companies tends to be higher.

**Economy of Scale**: a proportionate savings in cost gained by an increased level of production.

- Horizontal Merger (Cont.)

- **Example: The 1998 merger of Daimler-Benz and Chrysler is considered a horizontal merger. These two companies manufacture and sell cars.**

- **Vertical Merger:**
    - A vertical merger is the merger of two or more companies that provide different supply chain functions for a common good or service.

    - For example, Company A is a manufacturer of handbags and Company B supplies the leather that is used to make these handbags.

# HYPO

AD Champagne Company (“ADC”) wants to expand its market base. Most people in the Northeastern part of the U.S. has heard of it. However, it wants most of the people in the United States to know who they are. While at a business meeting someone suggests to the owner of ADC that they should merge with another company. You are ADC’s attorney which type of merger would you suggest, if any? Is a merger the proper avenue for brand and name expansion? If so, why?

# What Is an Acquisition?

An acquisition is a **financial transaction** where one company purchases most or all of another company's shares to gain control of that company.

a firm buys more than 50% of a target company's shares, it effectively gains control of that company.

An acquisition is often friendly, while a takeover can be hostile.

Acquisitions are often carried out with the help of an investment bank, as they are complex arrangements with legal and tax ramifications.

# Acquisitions (Cont.)

Acquisitions are usually friendly endeavors. They occur when the target firm agrees to be acquired, which means its board of directors approves of the deal. Friendly acquisitions often work toward the **mutual benefit** of the acquiring and target companies.

# Reasons for Acquisitions

- Entering a New or Foreign Market
- Growth Strategy
- Reducing Excess Capacity and Decreasing Competition
- Gaining New Technology-Sometimes it can be more cost-efficient for a company to purchase another company that already has implemented a new technology successfully than to spend the time and money to develop the new technology itself.

## Acquisition vs. Takeover vs. Merger

An acquisition generally describes a primarily amicable transaction, where both firms cooperate. A takeover, on the other hand, suggests that the target company resists or strongly opposes the purchase. The term merger is used when the purchasing and target companies mutually combine to form a completely new entity.

# Acquisitions are primarily a financial transaction and are often friendly?

True

0%

False

0%

None of the above

0%

8

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# Acquisitions are primarily a financial transaction and are often friendly?

True 87.5%

False 0%

None of the above 12.5%

## Types of Acquisitions

- Vertical
- Horizontal
- Conglomerate
- Congeneric

- **Vertical Acquisition** : The parent company acquires a company that is somewhere along its supply chain, either upstream (such as a vendor/supplier) or downstream (a processor or retailer).
- Example McDonald’s acquires a dairy farm for its cheese and milk products.

- **Horizontal Acquisition:** The parent company buys a competitor or other firm in their own industry sector, and at the same point in the supply chain.
- Example: McDonald’s buys Burger King

- **Conglomerate Acquisition :** The parent company buys a company in a different industry or sector entirely, in a peripheral or unrelated business.

- Example:  McDonald's buys a small Southern bank.

- **Congeneric Acquisition:** Also known as a market expansion, this occurs when the parent buys a firm that is in the same or a closely-related industry, but which has different business lines or products.

- McDonald’s buys a company that franchises fried chicken, like Kentucky Fried Chicken.

HYPO:

Baby Care Children’s Wear (“Baby Care”), a children’s clothing store, wants to increase their profit and make their shareholders happy. As their attorney, what kind of acquisition would you suggest and why?

- **Takeover or Hostile Takeover**

- The term hostile takeover refers to the acquisition of one company by another corporation against the wishes of the former. The company being acquired in a hostile takeover is called the target company while the one executing the takeover is called the acquirer.

# Hostile Takeover (Cont.)

- An acquiring company can achieve a hostile takeover by going directly to the target company's shareholders or fighting to replace its management.
- Hostile takeovers may take place if a company believes a target is undervalued or when activist shareholders want changes in a company.
- A tender offer and a proxy fight are two methods in achieving a hostile takeover.
- Target companies can use certain defenses, such as the poison pill or a golden parachute, to ward off hostile takeovers.

- Hostile Takeover (Cont.)

- A golden parachute consists of substantial benefits given to top executives if the company is taken over by another firm, and the executives are terminated as a result of the merger or takeover.

- For example: Meg Whitman, chief executive officer (CEO) of Hewlett-Packard Enterprise, stood to receive almost $91 million if the company was acquired under her control. She was also promised more than $51 million in compensation if she was terminated.

- Hostile Takeover (Cont.)

- A **poison pill** is designed to discourage a major acquisition of shares and a company's hostile takeover by an individual or entity. Once activated, the strategy allows shareholders, with the exception of the acquiring party, to buy additional shares of company stock at a highly discounted price.

**DUE Diligence- Pages 42-64**

Students, please note that I have updated my explanation of Goodwill in this section.

M&A Due Diligence

Due Diligence: reasonable steps taken by a person in order to satisfy a legal requirement, especially in buying or selling something.

- **Seller Entity Information**

- Organization, Governance, and Good Standing

- Articles of Organization; by-laws; operating agreements; shareholder agreements
- Identify shareholders, directors, and officers
- Minute books
- Communications with shareholders
- List of business names and business locations
- Issued and applied permits and business licenses (USA and International)
- Corporate policies and procedures

- **Ownership and Control; Change of Control Restrictions**

- Capitalization tables-Details who owns the company. Information concerning name, how much they own and what is the percentage of that ownership.
- Outstanding shares, convertible securities, options, and warrants
- Dividend/distribution policies
- Voting agreements- A voting agreement is a contract in which shareholders agree to vote a certain way on specific issues without giving up their shares or voting rights.
- Transfer restrictions

# Ownership and Control; Change of Control Restrictions (Cont.)

- Pre-emptive rights-purchase newly issued stock before offered to others.
- Consent requirements: Proof that “powers that be” consent to Merger or acquisition.
- Related party transactions
- Merger or reorganization agreements

When merging and acquiring what do you think will happen to the leadership team?

- **Subsidiaries, Affiliates, and Joint Ventures**

- Entity organization chart and descriptions for all related entities
- Gather the information listed above for all related entities.

**Seller Financial Information**:

- Assets and Operations:
- Financial statements and projections
- Sales and revenue
- Cost analyses; balance sheet
- Budgets; cash flow
- Debt schedules
- Loan, financing, and security agreements (including collateral and liens); payments and defaults
- Bankruptcy or insolvency
- Auditor reports

## Assets and Operations (Cont.)

- Internal control procedures
- Bank and investment accounts
- Owned and leased real estate
- Inventory/Valuations
- Manufacturing (owned and outsourced)
    - Sites
    - Products produced
    - Capacity
- Equipment and other tangible assets
- Intangible assets (including goodwill; customer lists; software and intellectual property rights

Goodwill is an intangible asset that is associated with the purchase of one company by another. It represents the value that can give the acquiring company a competitive advantage.

It Includes :

Brand Recognition

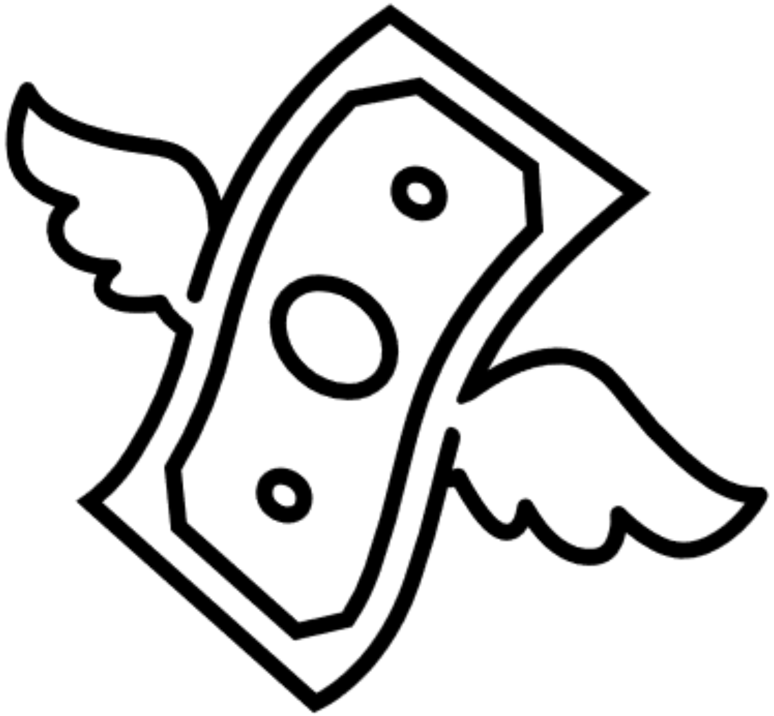
Reputation

Customer Base

Charitable Causes

Employee Relations

- Seller Financial Information:
- **Taxes**
- Identify all locations where taxes paid
- State, federal, international tax returns
- Payroll taxes
- Sales taxes
- Accruals, withholding and FICA
- Correspondence with taxing authorities



Seller Financial Information:

**Contracts and Commitments**

Commercial Contracts

- Purchase or sale of substantial assets
- Distributor; franchise; VAR
- Supply agreements
- Sales agreements
- Customer agreements
- Electronic marketplace agreements
- R&D; development or acquisition of technology
- Leases; rental agreements
- IT support; telecommunications; web development
- Data processing and storage; cloud computing
- Marketing and advertising

Seller Financial Information:

**Contracts and Commitments (Cont.)**

- Suppliers or customers outside the USA
- Current form agreements (sales; PO; invoices)
- IT support; telecommunications; web development

- Seller Financial Information: (Cont.)

- **Business Protection/Restrictions:**

- Non-competition; non-solicitation
- Non-disclosure; confidentiality
- Exclusivity
- Indemnity agreements- One party agrees to pay the other party for loss.
- Guarantees- Formal promise, usually to pay a debt.

What are the constructs of a merger and/or acquisition in Russia, if any. In other words, are they as detailed as the process we are currently discussing?

- **Government; Compliance with Law**
- Communication with Government or Regulatory Agencies
- Consents/approvals to do business
- Government contracts
- Inquiries, notices, reports, or correspondence
- Import/Export—restrictions or exemptions granted or denied

- **Regulatory Compliance Reports and Policies (Non-Employment**)
- Studies or data on compliance efforts such as Environmental Protection Agency prevention and remediation/safety
- Policies and other materials documenting:
  - Compliance with regulatory agency rules
  - ESG – Environmental Social and Corporate Governance
  - Privacy

- **Privacy and Data Security**

- Identify type of information collected and business purpose
- Identify USA and international privacy regulations that apply such as FTC/TCPA/COPPA/CAN-SPAM; HIPAA; GLBA; GDPR; state
- Identify security standards and procedures required and implemented (examples are HITECH; PCI-DSS; ISO/IEC; NIST)
- Data security breaches or cyberattack

- **Intellectual Property**
- Owned and Licensed IP (Worldwide)
- Patents
- Trademarks and service marks
- Copyrights
- Know-how; trade secrets
- Internet domain names
- Invention disclosure, and assignment agreements
- Royalty agreements
- Legal opinions or common interest agreements related to any of the above

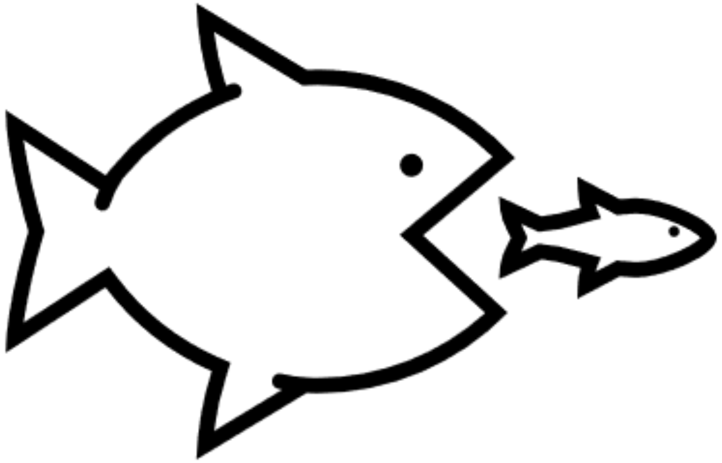
- **Software**
- Software inventory (owned and licensed)
    - Object code and source code
    - Opensource software
    - APIs- Provide instructions on how apps can use operating systems
    - Mobile apps
    - Social media plug-ins
- Operating systems
- Databases
- SaaS; CRM; accounting; reporting and similar platforms used by the business

**Litigation**

Commercial

- All pending and threatened cases (including demand letters)- Called infringement actions.
- Settled litigation and judgements
- Damages; payment schedules

- **Products and Services**
- **Offerings**
- List of products and services offered
- List of products and services under development
- **Warranties**
- Recalls and product liability claims
- Warranties offered in contracts, sales literature, websites, in practice
- Material warranty claims made/paid



- **Business and Competitive Intelligence**
  - Top-selling products/services
  - Largest customers
  - Largest suppliers
  - Major competitors for each business segment and for top-selling product/services.

- **Personnel and Benefits**
  - Personnel and Policies
  - Compensation
  - Benefits- stock options, health insurance, severance 401(k)
  - Workers Compensation
  - Unemployment
  - Collective Bargaining

- **Finalizing Deal:**

- When the buyer has completed due diligence and plans to move forward, solicit final board approval. Sign the definitive agreement. Once you sign the final agreement, the deal is closed you have either merged with or been acquired by another company, and integration begins.

What kind of information do you believe is memorialized in the final merger or acquisition contract?

THE END!

# SOURCES:


1. https://www.investopedia.com/terms/m/mergersandacquisitions.asp

2. https://www.ey.com/en_us/strategy-transactions/buy-integrate?WT.mc_id=10651314&AA.tsrc=paidsearch&s_kwcid=AL!10073!10!76622388208333!76622448505986&msclkid=3db6d057c5d516bc884fb53065a33585&utm_source=bing&utm_medium=cpc&utm_campaign=Buy%20Integrate&utm_term=merger%20and%20acquisition%20process&utm_content=Mergers%20%26%20Acquisitions%20-%20Phrase%20-%20Desktop