EXAM NO. _____

MERGERS & ACQUISITIONS

Professor John Orcutt

Spring Semester 2003

FINAL EXAMINATION

Instructions:

1. This is an open-book examination. You may bring any materials you wish to the examination with the exception of computers, telephones or other electronic devices. Calculators, however, are permitted – although I do not believe they will be necessary.

2. This is a 3-hour examination. There is 1 essay question and 3 short-answer questions for this examination. The point allocation by question is as follows:

   ▶The essay question will be worth 70 points
   ▶The three short-answer questions will be worth 20 points each (for a total of 60 points)

   It is your responsibility to apportion your time appropriately amongst the four questions. If you base your time on the number of possible points per question, the time apportionment should be:

   ▶Question No. 1 = 97 minutes
   ▶Questions No. 2 through 4 = 27 2/3 minutes each (for a total of 83 minutes)

3. Do not write your name on the examination or your blue books – only your examination number.

4. ***For Question No. 1 (the essay question):*** Please answer the question in a blue book. Remember to write your examination number on each blue book that you use. The only answers that will be graded are the answers written into blue books. While you are free to use scratch paper, answers written on scratch paper, or anything else other than a blue book, will not be read and will not be counted for any credit. Please write only on the front side of the pages in the blue book.

5. ***For Questions No. 2 through 4 (the short-answer questions):*** Please write your answers in the space provided in the examination booklet. Your answers may not exceed the amount of space provided for you in the examination booklet. DO NOT WRITE YOUR ANSWERS FOR QUESTIONS NO. 2 THROUGH 4 IN BLUE BOOKS.

6. Please remember that organization, persuasiveness, neatness and legibility all count in determining your grade on an answer. To improve the organization of an answer, you may wish to quickly outline the answer on a separate sheet of paper prior to writing your full answer in the blue book.

7. Should you find it necessary in answering a question to assume a fact not given in the problem as stated, you may do so. However, you should clearly indicate that you are making an assumption and you should explain why you consider it a reasonable assumption to make.

Good luck on the examination!

DO NOT TURN TO PAGE 2 UNTIL THE PROCTOR TELLS YOU TO BEGIN

QUESTION NO. 1 (70 points possible):

April 30, 2003: You are an attorney with Milkem and Bilkem, a leading Wall Street law firm, where you specialize in M&A transactions. You have just received a phone call from Earvin Johnson, the CEO of Teeth Co., and he has asked for your advice. Teeth Co. is a Delaware corporation listed on the New York Stock Exchange and is one of the largest manufacturers and distributors of traditional orthodontic devices (*i.e.*, appliances and devices for straightening teeth) in the United States.

Teeth Co. is considering a possible business combination with Invisible Braces, Inc. ("IB"), a Delaware Corporation that is privately held (*i.e.*, it is not listed on a national exchange and it is not required to file public reports under the Exchange Act of 1934, as amended). IB manufactures and distributes an esthetic orthodontic appliance (the "Appliance") that corrects malocclusion (*i.e.*, crooked teeth) using a series of custom-made, nearly invisible, removable teeth aligners. IB sells the Appliance in all 50 states and is the dominant provider of invisible orthodontic appliances in the United States.



The Appliance

Teeth Co. is very interested in broadening its product line to take advantage of the growing popularity of invisible orthodontic appliances. Currently, invisible orthodontic appliances constitute only 2.8% of all orthodontic appliances employed in the United States. However, Teeth Co.'s management estimates that within five years invisible orthodontic appliances will constitute approximately 35% of all orthodontic appliances employed in the United States.

To explore business combination possibilities with IB, Earvin Johnson has held several informal meetings with Larry Bird, who is the CEO of IB. The purpose of the meetings was to explore whether a business combination between the two companies makes any sense whatsoever. The following information came out of the meetings:

1. Each of Teeth Co. and IB value the assets of IB at approximately $100 million.

2. Teeth Co. and IB, however, differ on the estimated cost of IB's liabilities:

   a. Teeth Co. estimates IB's liabilities as follows:

      ►**Tort Lawsuits = $10 million.** Teeth Co. is concerned about possible future tort litigation arising from past sales of the Appliance. During its background due diligence investigation, Teeth Co. uncovered a $100,000 lawsuit from a user of the Appliance which claims that a defect in the product caused severe contusions and bleeding of the gums. It turns out that from 2000 through 2002, the Appliances were manufactured in a way that caused the edges for 1 out of every 500 Appliances to be slightly rough which could cause severe contusions and bleeding of the gums for persons with hyper-sensitive gum tissue. This manufacturing problem was corrected at the end of 2002 and no longer appears to be a problem.

►**Environmental Clean-up = $10 million.** The property under IB's manufacturing facility may have been contaminated by IB. IB has paid for a preliminary survey of the cost for cleaning up the contamination and has received an estimate that the clean-up cost will be between $2 million and $10 million. Teeth Co. has been burned by environmental liabilities in the past and takes a very conservative approach towards valuing the cost of environmental clean-up.

►**All Other Liabilities = $5 million.**

b. IB estimates its liabilities as follows:

►**Tort Lawsuits = $100,000.** In order for the gum injuries to occur, it requires both (1) a defective Appliance and (2) a user with hyper-sensitive gums. Based on some statistical analysis it conducted, IB believes that it is highly unlikely that more than 10 users of the Appliance might have suffered from the severe injuries. Moreover, IB is confident that it can settle any such lawsuits (including the current $100,000 lawsuit) at approximately $10,000 per plaintiff.

►**Environmental Clean-up = $2 million.** IB believes that the estimate range for the environmental clean-up is silly. The reason for the environmental clean-up is that IB's manufacturing facility has three underground heating oil tanks located on the premises. Two of the tanks have developed leaks which have caused a contamination problem. The two tanks need to be replaced and the leaked oil must be cleaned up. The range for the clean-up is so large because the environmental examiner did not have a copy of the soil study report for the manufacturing facility. If the leaking tanks are located in loose, easily movable soil (making the excavation relatively simple), the clean-up cost will be $2 million. If the leaking tanks are located in hard, stoney soil (making excavation very difficult), then the clean-up will be $10 million. IB knows that the tanks are located in loose, easily movable soil.

►**All Other Liabilities = $5 million.**

3. Central to the Appliance are the following intellectual property rights:

a. A patent (the "Patent") that IB holds on the removable teeth aligners that has another 12 years of life; and

b. A non-exclusive patent license (the "Patent License") that IB has obtained from Plastic Co. relating to the invisible materials used to make the Appliance. The license agreement with Plastic Co. provides that the Patent License is not assignable without the prior written consent of Plastic Co. IB has always stayed current on its royalty payments on the Patent License. In addition, it turns out that Teeth Co. is the licensee on a few unrelated patent licenses with Plastic Co. and considers its relationship with Plastic Co. to be solid. A copy of the assignment clause for the Patent License is set forth immediately below.

> "**Section 11 – Assignment:** Licensee [IB] may not assign this license agreement without Licensor's [Plastic Co.] prior written consent, which consent shall not be unreasonably withheld. For purposes of this section, a Change of Control shall be deemed an assignment. "Change of Control" as used herein shall mean: (1) a sale of all or substantially all of Licensee's assets; (2) a merger or consolidation in which the Licensee is the surviving

corporation; (3) a reverse merger in which the Licensee is the surviving corporation but the shares of voting stock of Licensee outstanding immediately preceding the merger account for less than 50% of the combined voting power entitled to vote in the election of directors upon consummation of the merger; or (4) an acquisition by any person or entity of securities of the Licensee representing more than 50% of the combined voting power entitled to vote in the election of directors of Licensee."

Finally, the partner you are working with at Milkem and Bilkem has informed you that the transaction needs to be structured so as to avoid "Revlon Duties".

YOUR ASSIGNMENT:

a. Please recommend the optimal structure for a Teeth Co./IB deal.

b. Please provide a diagram of the structure.

c. Please provide a thorough explanation of why you have chosen your recommended structure and describe any issues of which Teeth Co. should be informed. Please include a description of (a) the required shareholder and director actions and (b) the applicable appraisal rights.

d. Please discuss your strategy for dealing with the Patent and the Patent License.

e. Please explain how you have managed to avoid triggering Revlon Duties. Please also explain why it is important for Teeth Co. that you avoid triggering Revlon Duties.

QUESTION NO. 2 (20 points possible):

April 30, 2003: Yankee Co., a publicly traded Delaware corporation, is a leading manufacturer of widgets. Yankee Co. is largely recognized for having the leading technology in the widget industry. Led by its visionary CEO George Steinbrenner, Yankee Co. has been able to achieve this technological leadership by acquiring a number of "up and coming" widget manufacturers that have had superior research and development programs. Most recently, on November 10, 2002, Yankee Co. closed an all-cash tender offer for the outstanding shares of Red Sox Co., a publicly traded Delaware corporation. Pursuant to the tender offer, Yankee Co. was able to acquire 78% of the outstanding shares of Red Sox Co. Upon consummation of the tender offer, Yankee Co. appointed 3 out of the 9 members of the Red Sox Co. board of directors. Yankee Co. would now like to conduct a cash squeeze-out merger for the remaining 22% of the shares of Red Sox Co. In conducting the squeeze-out, Yankee Co. intends to require the three "Yankee-appointed" directors to recuse themselves from all decisions relating to the squeeze-out, including (1) all negotiations related to the terms of the squeeze-out and (2) the approval of the final terms of the squeeze-out. In addition, the remaining six Red Sox Co. directors will hire independent financial advisors and legal counsel to assist them with the squeeze-out merger.

Your questions ***(Please answer this question in the space provided in this examination booklet. Do NOT write your answer in a blue book)***:

a. Certain of the 22% Red Sox Co. shareholders who are to be squeezed out are unhappy with the terms of the squeeze-out merger. These shareholders have brought a lawsuit alleging that the board of directors of Red Sox Co. breached its fiduciary duties in conducting the squeeze-out. Please explain the standard of review that a Delaware court would apply to such a controversy?

b. Would your analysis change if the Yankee-appointed directors on the Red Sox Co. board had not recused themselves from decisions relating to the squeeze-out?

c. Are the 22% Red Sox Co. shareholders that are to be squeezed out entitled to appraisal rights in the squeeze-out merger?

QUESTION NO. 3 (20 points possible):

April 30, 2003: Looking Glass Networks Inc. ("LGN"), which is a major manufacturer of optical equipment for the telecommunications industry, is considering acquiring certain of the assets of Franklin Pierce Laser Co. ("FPLC"). FPLC, a Delaware corporation, is a manufacturer and distributor of specialty lasers that are used in the telecommunications industry. FPLC has been operating since the early 1980s and has enjoyed close to 20 years of strong success. Unfortunately, the new millennium has not been very kind to FPLC. As a result of the severe decrease in capital spending in the telecommunications industry, FPLC's revenues decreased dramatically and FPLC has experienced net losses in each of the last three years. FPLC is rapidly heading towards insolvency.

Your questions ***(Please answer this question in the space provided in this examination booklet. Do NOT write your answer in a blue book)***:

a. Assuming you are representing LGN, can LGN legally purchase certain of the assets of FPLC? What are the consequences to LGN?

b. Assuming you are representing FPLC, can FPLC legally sell certain of its assets to LGN? What are the consequences to the board of directors of FPLC?

c. Assuming that LGN is very intent on acquiring FPLC's assets, what are LGN's most attractive options?

QUESTION NO. 4 (20 points possible):

This question involves three corporations, all of which are publicly-traded Delaware corporations: (1) A Corp. (the target); (2) B Corp. (the initial buyer); and (3) C Corp. (the Gray Knight). On February 1, 2003, B Corp. entered into a stock-for-stock merger agreement (the "Merger Agreement") with A Corp. pursuant to which B Corp. will acquire A Corp. in a forward triangular merger (the "Merger"). Because A Corp. is a publicly-traded Delaware corporation, the parties realized that it would take approximately 6 months before the deal could be closed. B Corp. did not want to be used as a "stalking horse", so it insisted on including some deal protections to ensure that the deal would be consummated. Specifically, the Merger Agreement includes the following clauses:

1. A clause whereby the board of directors of A Corp. agrees to recommend to the stockholders of A Corp. to vote in favor of the Merger;

2. A "no-shop" clause whereby A Corp. (including its officers and directors) agrees not to solicit any offer or proposal from a third party to acquire A Corp.;

3. A "no-talk" clause whereby A Corp (including its officers and directors) agrees not to furnish any non-public information to any third party that makes or considers making a proposal to acquire A Corp.

4. A "fiduciary out" clause was not included in the Merger Agreement.

Your questions ***(Please answer this question in the space provided in this examination booklet. Do NOT write your answer in a blue book)***:

a. Assume that you are the attorney representing the board of directors of A Corp. On April 10, 2003, C Corp. makes an unconditional offer to acquire A Corp. that is substantially, and objectively, superior to B Corp.'s offer. Please advise the board of directors of A Corp. on what they should do.

b. Please explain the standard of review that a Delaware court would apply to the deal protections in the Merger Agreement (*i.e.*, the agreed board recommendation, the no-shop clause and the no-talk clause)?

END OF EXAM * * * * *

FOR THE 3Ls AND THE GRADUATE STUDENTS: Enjoy wonderful careers and please keep in touch.

FOR THE 2Ls: I look forward to seeing you next year.