EXAM NO. _____

**MERGERS & ACQUISITIONS**

Professor John Orcutt

Spring Semester 2003

**MIDTERM 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 90-minute exam and is worth 50 points.

3. The examination consists of 2 essay questions. The point distribution for the questions is as follows:

   ▶ Question No. 1 will be worth 30 points
   ▶ Question No. 2 will be worth 20 points

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

   ▶ Question No. 1 = 54 minutes
   ▶ Question No. 2 = 36 minutes

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

5. Please use a separate blue book for each answer. 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.

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 (30 points possible):**

**March 10, 2003:** ABC Company ("ABC") is a Delaware corporation and 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). ABC designs, manufactures and sells tunable optical components for the telecommunications industry, such as tunable lasers, tunable filters, tunable receivers and optical switches for advanced optical networks.

In 2000, with the optical networking boom in full bloom, ABC was an extremely hot company and was able to raise a substantial amount of money. Specifically, ABC raised $50 million of preferred stock in a Series A round of financing (the "Series A Preferred Stock"). The relevant provisions of the Series A Preferred Stock investment contract are set forth below:

> **Clause 4.1**: Beginning on June 15, 2003, ABC will pay to the holders of Series A Preferred Stock ("Series A Holders") a mandatory dividend of $1.50 per share per annum. Dividend payments will be made on June 15th of each year.
>
> **Clause 5.1**: ABC may not, without the affirmative vote of greater than 50% of the outstanding shares of Series A Preferred Stock, alter or change any rights, preferences or liquidations of the Series A Preferred Stock pursuant to Section 242 of the Delaware General Corporation Code.
>
> **Clause 5.2**: Except as otherwise provided by law or by Clause 5.1 above, the shares of Series A Preferred Stock and the shares of Common Stock of ABC shall be voted together as one class.

Because of the substantial slowdown in capital spending in the telecommunications sector, ABC has not been able to generate the level of profits that it expected. As a result, ABC is concerned that the upcoming June dividend payment to the Series A Holders will substantially deplete ABC's cash reserves and will substantially impinge on the future success of ABC. ABC does not expect its profits or its cash reserves to substantially improve over the next few years and views the June 2004 and June 2005 dividend payments as even more problematic (ABC cannot forecast beyond June 2005).

ABC has contacted the Series A Holders to try to discuss renegotiating the terms of the Series A Preferred Stock. Specifically, ABC suggested that the dividend payments be eliminated in exchange for ABC issuing a certain number of shares of ABC common stock to the Series A Holders. The Series A Holders flatly rejected ABC's proposal and informed ABC that they expected to receive their dividend payments.

You are an attorney with Milkem and Bilkem, a leading Wall Street law firm, where you specialize in M&A transactions. ABC is one of your most important clients and has called you to assist it with its problem with the Series A Holders. ABC has asked you whether something can be done to eliminate the Series A Preferred Stock dividend payments.

ABC's only two classes of equity stock are its Common Stock and the Series A Preferred Stock. ABC's capital structure is as follows:

(a) **Common Stock**:
- ▶ Authorized = 10,000,000 shares
- ▶ Issued = 5,000,000 shares
- ▶ Treasury = 500,000 shares
- ▶ Outstanding = 4,000,000

(b) **Series A Preferred Stock:**
- ▶ Authorized = 1,000,000
- ▶ Issued = 1,000,000
- ▶ Treasury = 0
- ▶ Outstanding = 1,000,000

(c) **Relative Voting Power:**
- ▶ Voting as a single class, the holders of common stock would have 80% of the voting power and the Series A Holders would have 20% of the voting power.
- ▶ Holders of approximately 95% of the outstanding common stock have informed ABC that they are in favor of eliminating the dividend rights of the Series A Preferred Stock and that they would not object to issuing additional common stock to the Series A Holders to accomplish this objective.

**YOUR ASSIGNMENT:**

a. Can ABC conduct a statutory recapitalization? Please explain.

b. Does ABC have any alternatives beyond a statutory recapitalization? If yes, please outline the possibilities. From the various possibilities, please choose the most logical alternative and explain it in detail. Such detailed explanation should include (1) a diagram of the structure, (2) a description of the required approvals and votes and (3) a description of the applicable appraisal rights. Please explain in detail the rights of the Series A Holders.

**QUESTION NO. 2 (20 points possible):**

**March 10, 2003:** XYZ Corp. ("XYZ") was a small, specialty publishing company that was 100% owned by three brothers: Moe, Larry and Curly Stooge. XYZ had two primary assets: (1) the exclusive license to publish five books written by Professor John Orcutt (the "License"); and (2) a favorable lease for prime office space (the "Lease"). Set forth below is additional information on the two assets:

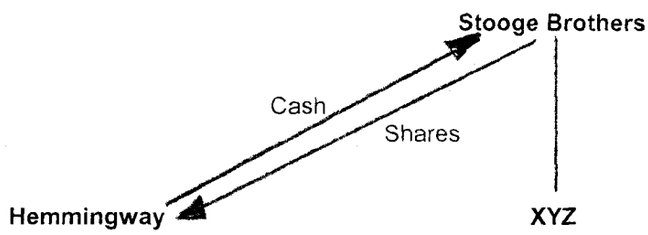
(a) **The License:** Professor Orcutt is an extremely popular writer. He has written five novels, all of which have become international best sellers. His five novels are of the genre "action thrillers" and are based on a character, John Bondcutt. Bondcutt is a dashing young business law professor who also serves as a top secret agent for the United States. The novels track Bondcutt's exploits as he repeatedly saves the world from utter destruction. XYZ holds the exclusive copyright license to publish these five books. The License is silent as to assignability.

(b) **The Lease**: XYZ holds a lease for 10,000 square feet of prime office space in mid-town Manhattan. The lease does not expire until 2012 and it provides XYZ with a rental rate that is approximately 40% below the current market rate for equivalent office space. The Lessor of the office space is Trump Partners. The Lease includes the following non-assignment clause:

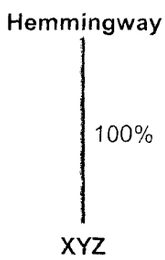
> "XYZ shall not sublet, assign, transfer or in any manner dispose of the said premises or any part thereof, for all or any part of the term hereby granted, without the prior written consent of Trump Partners. Such consent may be withheld for any reason whatsoever at the sole discretion of Trump Partners."

In December 2002, Hemmingway Group, Inc. ("Hemmingway"), a leading publishing company, purchased 100% of the stock of XYZ from the three Stooge brothers in an all cash transaction. Below is a diagram of the transaction that took place:

**Transaction Diagram:**




**Post-Transaction Structure:**



Following completion of the cash tender offer, XYZ continues to publish Professor Orcutt's five novels. In addition, Hemmingway intends to (a) remove the XYZ operations from the space covered by the Lease and (b) move another of its publishing divisions into the space covered by the Lease.

(1) Professor Orcutt did not consent to Hemmingway taking over XYZ's operations and is looking to cancel the License.

(2) Trump Partners did not consent to an assignment of the Lease and is looking to cancel the Lease.

You are an attorney with Milkem and Bilkem, a leading Wall Street law firm, where you specialize in M&A transactions. Hemmingway has just fired its previous M&A counsel and has hired Milkem and Bilkem to assist it with the Professor Orcutt/Trump Partners issues.

**YOUR ASSIGNMENT:**

Please advise Hemmingway on the following two issues:

a. Can Professor Orcutt cancel the License? Please explain.

b. Can Trump Partners cancel the Lease? Please explain.