M&A AND SECURITIES LAW – SELECTED RECENT DEVELOPMENTS AND OVERVIEW

Rod J. Howard

Biographical Information

Rod J. Howard

Primary Areas of Practice: Mergers & Acquisitions, Securities and Corporate Law, Corporate Governance

Law School: University of Chicago Law School, 1982

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M&A and Securities Law – Selected Recent Developments and Overview

Rod J. Howard[1]

Corporate mergers and acquisitions play out against the backdrop of numerous areas of law. Federal securities law is one of the main and more pervasive legal backdrops to the M&A process, regulating or influencing nearly all major stages of the transaction process.

M&A today also plays out against the backdrop of corporate and accounting abuses, the response to these abuses by Congress and federal regulators (including the new securities law provisions adopted by Sarbanes-Oxley, new SEC and stock exchange rules, and new court decisions) and the response of corporate boards, managers and investors.

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[1] At the time of writing, the author -- who is currently the founding senior managing director of CapKey Advisors, A Professional Corporation -- was a partner in the law firm of Weil Gotshal & Manges, LLP (Silicon Valley Office). This outline was prepared as a set of "speaking notes" and is not intended either as a comprehensive treatment of the subject matter or as legal advice for any specific situation. In addition, this outline does <u>not</u> address tender offers (which are covered by another speaker in the program and other materials in the program book) or litigation that may arise or be pursued in connection with M&A transactions. The views expressed in this outline are the author's personal views and do not necessarily reflect the views of the author's firm or any other person. This outline does <u>not</u> address tender offers, which are addressed in another segment of the program.

Scope of topic: The focus of this segment of the program is on significant recent securities law developments, as well as the basic securities law considerations that affect the M&A process – in particular, the statutes, rules and rulings relating to public disclosure, the registration and issuance of securities, and the solicitation of stockholder approvals. The rules regulating tender offers will be covered in another segment of the program and are not covered in this segment or in this outline. The focus of this segment and outline is that a "corporate" and transactional lawyer; while the rules and results of a number of courts cases are cited, the multiplicity of litigation that can arise or be pursued in connection with M&A transactions is beyond the scope of this segment and outline.

I. Overview

A. Overview of Major Trends in M&A – impact of governance & disclosure scandals & reforms

- Strong rebound in M&A market – After three soft years, the M&A market has rebounded strongly.
- Business recovery – Operating results and business confidence (important factors in M&A) have strengthened. At the same time, elements of caution remain about the durability of the recovery and the risk of external shocks to economic conditions and prospects.
- Distraction: Corporate scandals and abuses, governance and disclosure reforms, new disclosure and controls requirements have distracted boards and management groups from M&A. With some of the major reforms in place, these distractions have lessened. But upcoming deadlines for compliance with SarbOx 404 may affect M&A.

- Results:
  - More careful, thorough and intensive "due diligence" before signing a deal. Longer deal cycles. In stock-for-stock deals, more "reverse due diligence" by sellers on the buyers.
  - Importance of financial statements and controls. More inquiry into off-balance-sheet items and exposures. More inquiry into related-party dealings.
  - Impact of deal on post-closing compliance (*e.g.*, quality, consistency and integration of disclosure controls and procedures, consolidation of financial statements, periodic reporting and CEO/CFO certification requirements).
  - New terms to negotiate – *e.g.,* new representations and warranties, covering risks exposed by recent scandals and compliance with requirements imposed by recent reforms.
- Increased personal liability exposure also means closer scrutiny of deals by directors and senior management:
  - CEO and CFO certifications, personal liability
  - Penalties if financial statements need to be restated due to wrongdoing
  - More independent directors, heightened audit committee responsibilities, more "defensive directoring" – greater general caution
- New SEC requirements, more SEC scrutiny
  - New disclosure requirements: new 8-K requirements (see Sections II.B.1 & VI below)
  - Heightened SEC scrutiny: The SEC, with expanded resources and responsibilities, and sensitive to undetected scandals and abuses, has intensified its scrutiny of virtually all filings, including "routine" filings.

  - Result: Longer review periods between signing and closing, greater risks of regulatory delay, including delay from extraneous issues not directly related to a transaction – *e.g.*, review of another filing.
- State-law developments -- new rules, more scrutiny
  - State regulators and courts more active. Even if not directly involving M&A transactions, this activity has implications for M&A.
  - While "business judgment rule" remains, stricter application of existing fiduciary duty doctrines has effectively meant closer scrutiny of directors' decisions
  - New limits on deal protection devices (*Omnicare* decision in Delaware)
  - New state-law disclosure duties in M&A transactions based on directors' fiduciary duties, with potentially different "materiality" standards. *E.g., In re Pure Resources Inc. Shareholders Litigation,* C.A. No. 19876 (Del. Ch. Oct. 1, 2002)*; Alessi v. Beracha*, C.A. No. 18993-NC (Del. Ch. May 11, 2004). ***See Section V below***
  - State scrutiny – more aggressive enforcement.
- Increased shareholder activism, with impact on takeover defenses (Breeden report on MCI, stockholder proposals repealing or requiring stockholder approval for "poison pill" rights plans and other anti-takeover measures), corporate governance, disclosure
- **Short-term effect on M&A:**
  - **Distraction, delay, caution**
  - **More public disclosure required, with more tendency to err on side of disclosure**
  - **Possible SarbOx 404 impact**
- **Long-term effect: "cleaner" companies, more reliable financial statements, fewer surprises,**

potentially positive impact on confidence of buyers, sellers and the broader investment community

B. <u>Intersection of securities law and M&A</u>

M&A transactions are regulated or influenced by federal securities law in at least a number of areas:

1. <u>Disclosure obligations</u>: Where a public company is involved, disclosure requirements may affect all stages of the transaction, from inception to closing:

(a) initial contact and discussions, term sheets, negotiations, letters of intent and other preliminary agreements (avoidance of leaks and other triggers for unwanted premature disclosure, prospectus delivery requirements if shelf S-4 will be used);

(b) signing and announcement (disclosure of material definitive agreements pursuant to new Item 1.01 of Form 8-K, other disclosures required by other new items of Form 8-K) (*see sections II.B.1 and VI below)*);

(c) post-signing "marketing" of the deal (filing of pre-proxy statement solicitation material pursuant to Exchange Act Rule 14a-12, pre-registration statement communications under Securities Act Rules 165 & 425 and pre-commencement communications under Rule 14d-2(b));

(d) pursuit of regulatory filings and approvals (proxy statement, registration statement in stock-for-stock deals);

(e) closing (or termination) of deal (8-K requirements for acquisitions of significant amounts of assets under Items 5.01 and 9.01, termination of material definitive agreements under Item 1.02); and

(f) post-closing (*e.g.,* financial statements and pro forma financials required by Item 9.01 of Form 8-K; delisting notices, quarterly and annual reports with disclosures covering combined company and CEO/CFO certifications).

Focus points include (i) compliance (making required disclosures when required) and (ii) avoiding events that may require unwanted premature disclosure that may damage the deal and the parties.

2. Insider trading restrictions: The legal prohibitions against "insider trading" – *i.e.*, trading on material nonpublic information or "tipping" others to the information – apply with special force in M&A because of the impact that M&A transactions often have on stock prices. Insider trading can adversely affect the deal process and carries severe criminal and civil penalties.

3. Due diligence & deal structuring/terms: The new disclosure and CEO/CFO certification requirements of Sarbanes-Oxley, new board and audit committee responsibilities, enhanced penalties, and the exposure of the abuses underlying these reforms have added additional issues for due diligence and increased the scope and depth of due diligence by buyers. These factors have also led to more "reverse due diligence" by target companies, particularly in stock-for-stock deals, where the target board and stockholders are effectively making an investment decision in the acquiror's stock. Sarbanes-Oxley may also influence deal structure and terms – *e.g.*, acquire assets but not entity, thereby leave the target's financials behind and avoid certifying the target's financials.

4. Proxy rules – stockholder approvals: Where a public company needs the approval of its stockholders under state corporate law or stock exchange rules for a merger, sale or acquisition, the solicitation of stockholder approval is regulated by the federal proxy statute (Section 14(a) of the Securities Exchange Act of 1934) and the SEC's proxy rules (SEC Regulation 14A).

- These approvals are typically required on the "sell side" but may also be required on the "buy side" (for transactions involving the issuance of large amounts of stock by the buyer).
- Asset sales also typically require approval of the seller's stockholders if "all or substantially all" of the company's assets are being sold. What constitutes "all or substantially all" varies from state to state and can mean 90% or more, in some states, or as little as half of the assets by purely quantitative numerical measures (or potentially less than half by historical quantitative measures if the assets are sufficiently important to future business), in other states.

5. Registration requirements to issue stock: Where stock is issued in stock-for-stock mergers and acquisitions, the shares must either be issued under an effective registration statement or a valid exemption from the registration requirements of federal (and state) securities laws. (Form S-4 is the form prescribed for the issuance of stock in M&A, but in acquisitions of private companies, shares may be issued as a private placement and registered for resale on Form S-3 if the issuer is "S-3 eligible" (or Form S-1 if the issuer is not S-3 eligible).)

6. Going-private transactions: Where a public company is acquired and "taken private" by insiders, the transaction must meet the SEC's "going private" rules. See, *e.g.*, Exchange Act Rule 13e-3 (going private transactions by certain issuers or their affiliates), *see also* Rule 13e-4 (tender

offers by issuers). This is beyond the scope of today's program and the time allowed. Two points worth noting here are (1) not every transaction in which a public company ceases to be a public company is a "going private" transaction for purposes of SEC rules, and (2) if the transaction is subject to the "going private" rules, special disclosure requirements will apply and the transaction will often be subject to special procedures, disclosures and limitations under state statutes and state corporate law fiduciary-duty and conflict-of-interest principles. *See e.g.,* California Corporations Code §1203 relating to "interested party" proposals and tender offers (requiring "an affirmative opinion in writing as to the fairness of the consideration to the shareholders of [the target] corporation" to be delivered to the target's shareholders (or board, if no shareholder action is required), and setting forth requirements relating to the opinion); California Corporate §500 (distributions).

7. Tender offers: Where a buyer offers to buy a public company by buying the stock directly from the target's stockholders, this is generally done by a "tender offer". The procedures are extensively regulated by SEC Regulations 14D and 14E and the "Williams Act" provisions of the Securities Exchange Act. Where an issuer makes a "self-tender", additional requirements apply. This topic will be covered in greater detail by the next speaker on the program.

II. Disclosure Considerations & Requirements

A. Before the definitive agreement

When a public company explores an M&A transaction, parties need to consider disclosure obligations. While disclosure of preliminary agreements, letters of intent and discussions has increased, the aim in most transactions continues to be to have the first public announcement be the announcement of a definitive agreement. Premature disclosure is generally undesirable for a number of reasons –

- can unsettle customers, employees and suppliers;
- can create impression that selling company is "damaged goods" and is not viable as a stand-alone business, especially if no deal results;
- can attract competing bidders or spoilers, increase the target's stock price (or decrease the buyer's stock price) and thereby make a deal impossibly expensive.

1. **<u>Basic Test</u>**:

The basic test of disclosure is the *Basic* test - *i.e.,* the U.S. Supreme Court's decision in *Basic v. Levinson*, 485 U.S. 224 (1988). Information must be <u>material</u>, AND there must be a <u>duty</u> to disclose.

- <u>Materiality</u>:
    - For preliminary merger discussions to be material, you need to weigh the magnitude of the transaction and the probability of its occurrence.
    - For target companies, a merger or sale of the company will usually have the requisite magnitude to be material; the only question will be whether or not a transaction is sufficiently probable.
    - For buyers, a deal may be too small to be material. But materiality depends not only on size, but other factors -- *e.g.,* strategic importance
- <u>Duty to disclose</u>. Materiality alone does not require disclosure; there must also be a duty to disclose - *e.g.,*
    - duty to make corrective disclosure ("no comment" versus "no");
    - open registration statement;
    - periodic filing requirement (*e.g.,* 10-Q or 10-K);

    - leaks;
    - insider trading;
    - ongoing transactions in company open-market stock buyback program or one-on-one stock buybacks by company.
    - *But note*: courts have said that the analysis of duty and materiality may "coalesce" in the case of corrective disclosure – *i.e.,* when new information is materially different from prior live statement.

- New 8-K rules: As adopted, the new 8-K disclosure requirements apply only to material definitive agreements and not to non-binding letters of intent, even if they contain binding nondisclosure or exclusivity provisions. As originally proposed, the rule would have required companies to file a Current Report on Form 8-K faster (within two rather than four business days after entering into any agreement that is material to the company and is not made in the ordinary course of its business) and would have applied not only to binding definitive agreements but also to letters of intent and other non-binding agreements. (Rel. No. 33-8106, 34-46084 (June 17, 2002).)
    - Disclosure of pre-agreement negotiations not required even under SEC's original 8-K proposal: Even in its original proposal, the SEC did not propose to require disclosure "about agreements still under negotiation." The SEC also emphasized that it did "not intend to change current law as to when disclosure about these negotiations is required." At the same time, the SEC noted that even under current law, "there may be instances when a company is under some other duty to disclose contract negotiations" (emphasis added).
    - But special circumstances or state law may require disclosure or negotiations: State law and

special circumstances may impose additional earlier disclosure obligations extending to negotiations (or may impose liability for nondisclosure). See, *e.g. Alessi v. Beracha*, C.A. No 18993-NC (Del. Ch. May 11, 2004) (refusing to dismiss a complaint based on nondisclosure of merger discussions during a stock buy-sell program where parties met a month before program was announced and discussed significant terms including valuation, and during pendency of buy-sell program the parties signed a confidentiality agreement and buyer's counsel provided a draft merger agreement, on the theory that the activities indicated interest in a transaction at the highest corporate level and the discussed valuation was at a significant premium).

- LOI's and "preliminary agreements" not commonly used in public-public deals; unsigned term sheets often used. NDA's are commonly used and the SEC's adoptive release for its new 8-K rules expressly recognizes that confidentiality agreements are not required to be disclosed. Similarly, the adoptive release states that exclusivity (no-shop) provisions and agreements for a limited time will not trigger the new 9-K disclosure requirements. It should be noted, though, that exclusivity agreements are often resisted and, even when accepted, closely parsed and negotiated. Depending on the circumstances, exclusivity agreements may implicate fiduciary as well as disclosure considerations, particularly if they result in a company being taken "off the market" for too long.

2. Note on Insider Trading

Although insider trading restrictions are not confined to material nonpublic developments before the announcement of the transaction, and apply with equal force to material nonpublic developments after the signing of the transaction, insider trading concerns first arise, and are often most acute, before public announcement of a transaction. There is an extensive body of case law defining what constitutes unlawful insider trading or tipping, which is outside the scope of this program and outline. Key points here:

- No trading by deal teams in either company's stock during pendency of discussions.
- Prohibition extends to sales as well as purchases (impact of transaction announcement is hard to predict and is not always positive). Prohibition extends to derivative securities (*e.g.,* listed options).
- Sophisticated surveillance systems in place to detect insider trading. Active enforcement programs.
- Severe civil and criminal penalties.
- Adverse impact on transaction process.
- Prohibition applies after signing and announcement of merger/acquisition agreement to material post-signing/pre-closing contingencies and developments (*e.g.*, status of pending regulatory approvals required for closing), and not just before initial public announcement of a deal.

3. Note on Shelf S-4s

"Acquisition shelfs" (shelf S-4 registration statements) can be useful for acquirors with active ongoing corporate acquisition programs. The process involves the filing of a shelf S-4, which includes a "base prospectus". Additional prospectuses are then filed for particular transactions by post-effective amendment. One practical note: in general, base prospectuses should be delivered to the target's negotiating team before serious discussions begin.

B. Disclosure obligations at and after signing of the definitive agreement

1. New 8-K Filing Requirements

New expanded and earlier 8-K disclosure and filing requirements were adopted by the SEC on March 16, 2004 (Rel. No. 33-8400, 34-49424) and are scheduled (as of this writing, in July 2004) to take effect on August 23, 2004. The new Form 8-K contains a number of items that may require disclosures at the time of signing of a merger or acquisition agreement, related material agreements, and related credit facilities. The new items that apply to or otherwise implicate M&A activity are reviewed in detail in Section VI of this outline. New Item 1.01 requires the disclosure of the entry into definitive material agreements (including M&A agreements) within four business days after signing. Item 1.01. In addition, other new items of Form 8-K require disclosure of the entry into material credit facilities (including M&A credit facilities) within four business days after signing, board and certain management changes, and other events that may implicate, accompany or follow from M&A transactions. ***See Section VI.***

2. Filing of certain communications

- Old rules: quiet periods with a limited exception immediately after deal announcement; 5-business-day clock to commence a tender offer
- "Real time" disclosure requirements. Disclosure requirements of the "new" M&A rules since January

2000: communicate freely (subject to anti-fraud rules), but file with the SEC on the day of first use

- requirements apply to all "written" communications
- broad definition of "written" -- scripts, slides, PowerPoints, handouts, transcripts, web-site postings, webcasts. But contrast speaking notes (versus script) and third-party recordings (versus issuer's own recording).
- required legends – participants in solicitation, interest in deal

- Selective disclosure -- Regulation FD prohibits "selective disclosure" to favored analysts, investors. Covers oral communications and fills part of the gap left by Regulation MA, which only applies to written communications.
  - Exception - Regulation FD doesn't apply to communications in connection with a registered offering
  - Recent high-profile enforcement actions by SEC against companies and individual officers. *E.g.,* Schering Plough, Siebel Systems, Raytheon, Secure Computing, Motorola.

3. Other Post-Signing Disclosure Considerations

- General heightened disclosure sensitivities as a result of corporate and accounting abuses. Some acquisitions have involved questionable and aggressive accounting.

- Regulation G:

    - New restrictions on non-GAAP "pro forma" financial measures – do not apply to financial measures included in disclosures relating to a proposed business combination if the disclosure is contained in a communication that is subject to the SEC's "real-time" M&A disclosure rules.

    - But note that the exemption (from Reg G and S-K Item 10(e)) for use of non-GAAP financial measures made in connection with a business combination, but only in communications subject to Rules 425, 14a-12 or 14d-2(b)(2), and Reg M-A Item 1015, and not to proxy or registration statements (or tender offer statements).

    - Otherwise, rules require GAAP comparables and reconciliation (*i.e.,* closest comparable GAAP number, and explanation of differences between the pro forma numbers and GAAP numbers), and explanation of how numbers are used by company and why believed to provide useful information for investors.

    - Non-cash exclusions only – pro formas may not exclude charges that are or can be settled in cash.

    - Recurrent "non-recurring items" prohibited (tested by 2-year look-back and look-forward).

- Use of non-GAAP measures disfavored by SEC – strong and articulated justification for use of non-GAAP measures and to avoid misleading disclosure. (*See* SEC Staff's FAQ Regarding the Use of Non-GAAP Financial Measures (June 13, 2003) (manner in which management uses the non-GAAP measure to conduct or evaluate its business, economic substance behind management's decision to use the measure, material limitations associated with use of the non-GAAP measure versus the most directly comparable GAAP measure, manner in which management compensates for the limitations, substantive reasons why management believes the non-GAAP measure provides useful information to investors.)

III. Proxy Statements, <u>Solicitation of Stockholder Approvals</u>

- Apply whenever stockholder approval is needed and proxies or consents will be solicited
- "Solicitations" very broadly defined – any communication calculated to lead to the giving or withholding of a proxy
- Old "gun jumping" rules prohibited solicitation without a proxy statement. Current rules allow pre-proxy statement communications but only if a copy of the communication (if it's a "written communication") is filed with the SEC on the day of its first use.
- Old rules allowed "silent" filings for preliminary proxy materials. Current rules don't – all filings are immediately public.
- Exemption for solicitations of up to 10 persons, but solicitations by issuers not exempted.

- Key disclosures often involve transaction background and reasons, description of transaction process, investment bankers' opinions.
- State law is increasingly imposing separate and sometimes additional disclosure obligations, over and above what federal securities law requires. *See, e.g.,* Delaware decisions discussed in Section V below.

IV. <u>Registration and alternatives</u>

- Stock-for-stock mergers and acquisitions require compliance with the registration requirements of the Securities Act of 1933 or an exemption from the registration requirements (*e.g.,* valid private placement under Section 4(2), Regulation D, or other valid basis)
- Section 3(a)(10) of the Securities Act – exemption for issuances of securities where the terms and conditions have been approved by a state official. Procedure available in California and a number of other states, and some foreign countries.
    - Overview of California fairness hearing procedures
    - Substantive review of transaction terms
    - No accounting review
    - SEC versus California Department of Corporations
    - Quick (at best), but also potentially unpredictable (at worst) – hearing is public, and anyone can appear including a rival bidder
    - Private company targets only
    - Need jurisdictional nexus

V. Selected Delaware Decisions and Their Interplay with Securities Laws

- *Omnicare* – impact on voting agreements, incentives for other deal structures with different implications under the securities laws (*e.g.*, stock purchase/tender offer, stockholder written consents instead of vote at meeting).
  - "Half life of a fruit fly" -- or a fly trapped in amber?
  - Various reactions in practice, ranging from business-as-usual to acceptance of looser lockups, from practical comfort to various "corporate" and "deal-structuring" "work-arounds"

- State-law disclosure duties (fiduciary duty of candor and disclosure).

  - Delaware courts are increasingly interpreting the fiduciary duties of good faith and candor to require directors to make disclosures to stockholders in connection with M&A transactions, beyond what may be required by federal securities law. *E.g., In re Pure Resources, Inc. Shareholders Litigation,* C.A. No. 19876 (Del. Ch. Oct. 1, 2002) (Strine, V.C.) (additional disclosure of investment bankers' analyses and other information regarding special committee process required, whether or not required by federal law and SEC rules).

  - *Alessi v. Beracha*, C.A. No. 18993-NC (Del. Ch. May 11, 2004) (refusing to dismiss a complaint based on nondisclosure of merger discussions during a stock buy-sell program where parties met a month before program was announced and discussed significant terms including valuation, and during pendency of buy-sell program the parties signed a confidentiality agreement and buyer's counsel provided a draft merger agreement, on the theory that the activities indicated interest in a transaction at the highest corporate level and the discussed valuation was at a significant premium) (citing, but holding not necessarily limited to, *Basic*).

- Tender offers versus mergers (means to avoid entire fairness review)

- Short-form mergers
  - disclosure duties
  - appraisal remedy
  - standard of review: no board action, no entire fairness review

VI. Summary of New 8-K Requirements with Implications for M&A

The SEC's new "real time" 8-K disclosure requirements have a number of provisions which either directly apply to various types of mergers, acquisitions, sales and divestitures, or implicate events that commonly occur in connection with (or follow from) M&A activity. Some of these new requirements represent a departure from current disclosure practices, while others represent more a change in form. The principal provisions are discussed below.

A. Items Directly & Broadly Applicable to M&A Transactions

Item 1.01 – material definitive agreements & amendments.

Summary: New Item 1.01 covers the entry into a material definitive agreement not in the ordinary course of business; and material amendments to such agreements. Nonbinding letters of intent are not covered, even where they contain some binding terms, as long as the terms are not material – examples of binding terms that are deemed immaterial include confidentiality and exclusivity provisions.

Required disclosures include: parties, date of agreement, brief description of material terms and conditions, brief description of any material relationship between the company or its affiliates and any of the parties other than in respect of the agreement being disclosed. The agreement itself is not required to be filed as an exhibit to the 8-K. Where the 8-K will be the first disclosure of the transaction, the 8-K can be used (on a "check the box" basis) to satisfy filing obligations under the rules relating to communications before the filing of a registration or proxy statement or the commencement of a tender offer under Rules 165, 14a-12, and 14d-2(b). To satisfy those other filing obligations, the 8-K must contain the disclosures required by those other rules, in addition to the disclosures required by Item 1.01 and any other applicable item of Form 8-K.

Impact: As proposed, the SEC's proposed new 8-K requirements, in particular the proposal to require disclosure of LOIs, would have been a marked departure from current practice. As adopted, the new 8-K requirements represent much less of a change. New Item 1.01 may require some additional disclosure that has not necessarily been made in the past (*e.g.*, description of the relationship of the parties

<u>other than</u> in respect of the agreement). It also changes voluntary disclosure practices into mandatory disclosure requirements, with a fixed time requirement (four business days after entry into the agreement).

But for many parties and transactions, the changes may be perceived as incremental and, in part, technical. In the past, parties to M&A transactions have frequently announced the signing of M&A agreements, typically by means of a press release, and often the press release (or a summary of the transaction) has been filed in a voluntary 8-K filing (under old Item 5). Often (though not always), the principal agreements have been filed as exhibits. In addition, since 2000, press releases and other written communications relating to certain M&A transactions have been subject to filing under Rule 165 and 425 under the Securities Act, Rule 14a-12 under the SEC's Proxy Rules (Securities Exchange Act), and Rule 14d-2(b) under the SEC's tender offer rules. These rules require that material be filed with the SEC on the day of first use and therefore may require disclosure *before* filing is required by new Item 1.01, which allow filing to be made four business days after the triggering event.

Materiality remains the linchpin of disclosure under Item 1.01. For public target companies, the case law indicates that a sale of the company will almost always be material. For buyers, the materiality of an acquisition must be assessed in light of the financial size of the transaction (*e.g.,* dollar size in cash deals, number of shares and percentage of market capitalization in stock deals, whether the transaction will result in a "significant subsidiary").

On occasion, parties have either delayed or avoided disclosure for some acquisitions, typically involving the acquisition of small privately held targets; these transactions will need to be reviewed in light of new Item 1.01, but they may continue to be non-material (and therefore not subject to mandatory disclosure) under Item 1.01. To the extent that a transaction requires the acquiror to issue stock in a private placement, 8-K disclosure may be required under Item 3.02 (discussed below), where disclosure might not previously have been made.

In addition, depending on their terms, some transactions may be subject to disclosure under other new items of Form 8-K, even if they are not subject to disclosure under Item 1.01. These provisions are also noted below.

Item 1.02 -- material termination of an Item 1.01 agreement. New Item 1.02 covers termination of a material non-ordinary-course agreement where termination is material and occurs other than by expiration on a stated termination date of by completion of performance of the parties' obligations. Disclosure is not required until actual termination; a threat of termination does not require disclosure. If a party believes in good faith that the agreement has not been terminate, disclosure is not required, but if a notice of termination has been received, disclosure is required.

In current practice, most M&A agreements contain a termination provision pegged to a "final date" or "drop dead date", but they typically do not result in the automatic termination or expiration of the agreement, but merely allow one or both parties to terminate the agreement. Often termination is subject to conditions (*e.g.,* compliance by the would-be terminating party with its obligations, absence of fault for the failure of the transaction to close by the stated date).

Item 2.01 – acquisition of a significant amount of assets.

Item 2.01 replaces former Item 2 – the mandatory 8-K filing triggered by the closing of an acquisition or disposition, not in the ordinary course of business, of a material amount of assets. As described by the SEC in its adoptive release, new Item 2.01 "retains most of the substantive requirements included in former Item 2 of Form 8-K". Although paired filings under Items 1.01 and 2.01 will often be made (Item 1.01 at signing, Item 2.01 at closing or acquisition of control), the items are tested at different times (when circumstances may lead to different results) and Item 2.01 establishes a bright-line financial threshold which differs from the more general "materiality" standard of Item 1.01. For these and other reasons, transaction agreements reportable under Item 1.01 will not always be followed by a report under Item 2.01.

Item 5.01 -- changes in control of registrant.

Item 5.01 replaces former Item 1 – the mandatory 8-K filing triggered by a change in control of the registrant. According to the SEC's adopting release, Item 5.01 was adopted in substantially the form proposed, which the SEC's proposing release in turn stated was "substantively the same as Item 1 of existing Form 8-K." Rel. No. 33-8106, 34-46084 (June 17, 2002).

B. Items Implicating M&A Transactions with Particular Terms

Depending on the structure and terms of the transaction, and other circumstances, a number of other new 8-K items may apply and require disclosure, including

- Item 3.02 (unregistered sales of equity securities), which may apply in acquisitions involving the issuance of unregistered stock or other securities by the acquiror. If the amount of equity securities sold, <u>in the aggregate</u>, since the issuer's last report under Item 3.02 or last periodic report (whichever is more recent) equals or exceeds 1% of the issuer's outstanding securities of the issued class, disclosure is required. Two points in particular are worth highlighting:

  - Under the aggregation provision, an unregistered stock-for-stock acquisition will be tested not only in isolation, but together with other similar acquisitions – and any other issuances of unregistered stock by the issuer. It is therefore possible for non-disclosable acquisitions to become disclosable later, as a result of subsequent developments.
  - New Item 3.02 may require disclosure regarding acquisitions even though they are otherwise "immaterial" and do not reach the threshold for disclosure under Item 1.01, Item 2.01 or any other item.

- Item 2.05 -- costs associated with exit or disposal activities (which may apply in certain divestiture situations.

- Item 2.06 (material impairments), which, like Item 2.05, may accompany or precede certain divestitures. In addition, acquisitions in recent years have sometimes resulted in significant write-offs and write-downs, particular acquisitions made at internet "bubble" valuations.

- Item 3.01 (delisting), which is implicated where the target company is public and in leveraged buyouts and going-private transactions.

- Item 2.03 (creation of a material direct or off-balance-sheet financial obligation), which may apply to certain types of acquisition debt and acquisition loan facilities, or to obligations acquired from a target company.

- Item 5.02 (departure or election/appointment of directors or principal officers), which may apply in M&A transactions involving changes in the composition of the combined company's board and/or senior management team (principal executive officer, president, principal financial officer, principal accounting officer, principal operating officer or other performing similar functions).

- Item 5.03 (amendments to charter documents), which may apply where an M&A transaction will involve charter and/or bylaw amendments. Note that item 5.03 only requires 8-K disclosure of charter and bylaw amendments that have not been disclosed in a proxy statement or information filed by the registrant. Since amendments to a certificate of incorporation or articles of incorporation typically require stockholder approval, Item 5.03 may come into play more frequently in the case of bylaw amendments, which typically can be effected by board action, than charter amendments.

- Item 3.03 (material modifications to rights of security holders), which may apply where existing securities will be restructured or exchanged for securities with materially different rights.