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Beyond Borders
China Outbound Investment

Buying a U.S. Business

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Buying a U.S. Business: An Overview

The current global economic conditions provide unprecedented opportunities for Chinese companies to secure or enhance a presence in the U.S. market and to acquire technology and know-how through M&A activity. Chinese companies with global aspirations that are poised to capitalize on these opportunities may prove to be particularly well placed to lead as no global businesses can excel without a presence in the U.S., just as they cannot excel without a presence in China.

The structure, complexity and timing of an acquisition of a U.S. business by a Chinese acquirer will depend upon a number of additional factors, including:

- the type of business to be acquired;
- the regulatory framework within which the target business operates;
- whether the acquirer is acquiring control or merely making a strategic or minority investment;
- whether the target business is publicly or privately held;
- whether the acquisition is a purchase of assets or shares or a merger;
- whether the acquirer is acquiring a parent company or a division, segment or subsidiary of a company; and
- the form of consideration.

In addition, acquiring a U.S. business may involve legal and regulatory issues at both the state and federal level. U.S. companies are generally formed under state law, and as such, governance and other corporate issues will be determined at the state level. Purely contractual matters are also typically governed by state law. The issuance of sale of securities, however, is largely regulated at the federal level, with some state involvement. As a result, the acquisition process for a company formed in Texas may vary somewhat from the process of acquiring a Delaware entity.

The first section of this paper addresses general considerations in buying a U.S. business many of which apply to both publicly-held and private businesses and the second section addresses the considerations unique to buying a publicly-held U.S. business. Each of the topics discussed in this paper involve complex issues and are only summarized very briefly below. Accordingly, this material is not a comprehensive treatment of the subject matter and is not intended to provide legal advice.

Deal Structures

The three principal methods of buying a U.S. business are:

- an asset acquisition;
- a share acquisition; and
- a merger or consolidation transaction.

Each principal method is discussed briefly below.

ASSET ACQUISITION

In an asset acquisition, the acquirer purchases all or a portion of the assets of a company or of a division, segment or subsidiary of a company and generally assumes only those liabilities it specifically agrees to assume. In most cases, the liabilities of the seller's business do not automatically transfer to an acquirer of the assets. Accordingly, an asset acquisition structure can provide flexibility to an acquirer that desires to acquire only certain identified assets or to limit its exposure to certain known or unknown liabilities. It is possible, however, for an acquirer to be held responsible for a seller's liabilities in certain limited circumstances, particularly in respect of environmental, products liability and tax matters, and for pension obligations if employees are transferred. Accordingly, a purchase investigation of the seller's business and obtaining appropriate contractual protections remain important in the context of an asset acquisition. Acquisition structures can be put in place, however, to help shield an acquirer's other assets from future claims. Approval of the board of directors of the acquirer and the board of directors (and in certain cases approval of the shareholders) of the seller may be legally required (or expected if not legally required) for an acquisition of assets.

In an asset acquisition, instruments transferring title must be prepared for each asset or category of assets and such transfer may trigger certain taxes, although generally there are no stamp duties in the U.S. Any such taxes on the transfer may be apportioned between the parties by contract. In addition, depending upon the nature of the assets acquired, the seller may be required to obtain consent from third-party contractual counterparties in order to effect the transfer and this process can vary greatly in terms of timing and complexity. Representations and warranties and indemnification from the seller (or seller's parent or principal shareholders) in the purchase agreement can provide meaningful protection to the acquirer after the closing.

SHARE ACQUISITION

In a share acquisition where the shares of the target are closely held, an acquirer customarily enters into one or a series of share purchase agreements with the target's shareholders While an agreement with all of the target's shareholders is preferable, if only a controlling majority of the target's shareholders agree to sell, the acquirer can nevertheless buy these shares in a first-step transaction and then eliminate the minority shareholders by merging the target and the acquiring subsidiary in a second-step merger transaction. But as described further below,

this process is not ideal as it creates appraisal rights and may lead to litigation by minority shareholders. Generally, in a share acquisition, all assets, liabilities and employees of the target business will remain with the target after its shares are transferred, but the acquirer can include contractual indemnity provisions to protect against liabilities that arise after closing. No instruments of transfer are necessary for the transfer of specific underlying assets and, generally, no transfer or sales taxes are imposed. The process of obtaining third-party consents is typically a much less involved process in share acquisitions although there may be contracts with change of control provisions which require the consent of the counterparty.

An acquirer generally seeks representations and warranties and indemnification from the target's parent company, if any, or from the target's principal selling shareholders.

MERGER OR CONSOLIDATION

A merger is the combination of two or more corporations into one of such corporations, and a consolidation is the combination of two or more corporations into a new corporation. These transaction structures are governed by state corporate law and based on statutory rules that can vary from state to state. The surviving corporation (in the case of a merger) or the new corporation (in the case of a consolidation) has all the rights, properties and liabilities of the constituent corporations. Upon effectiveness of the merger or consolidation, the legal existence of the non-surviving corporation(s) ceases, and former shareholders of such corporation(s) receive cash, shares of the new or surviving corporations, other securities or some other form of consideration for their shares. Mergers and consolidations generally require approval of the shareholders (the approval threshold required varies from state to state) and the boards of directors of both constituent corporations, and shareholders of the constituent corporations who do not support the transaction often have appraisal rights. Appraisal rights entitle a shareholder to receive "fair" value for the share in a merger or consolidation transaction which they can claim through a statutory procedure that may involve going to court.

Form of Consideration

Payment for an acquired business can be in the form of cash, shares, promissory notes or other debt instruments, or a combination of the foregoing. An acquisition effected by the exchange of securities of the acquiring corporation for shares of the target might require registration of the acquirer's securities with the U.S. Securities and Exchange Commission (the "SEC") if the target is widely held or if the target's shareholders insist on receiving securities that are readily marketable. Registration of securities with the SEC entails detailed disclosures about the issuer of the securities and, compared with cash consideration, can result in additional expense and longer periods between deal announcement and closing. The issuance of securities in mergers in which shareholders are asked to vote or otherwise make an election to receive new securities can also require registration with the SEC.

Payment in the form of securities is also more likely to require corporate formalities, such as approval of the acquirer's shareholders. The amount of consideration paid in an acquisition need not be fixed but may vary based upon events determined or occurring after the closing. For example, if the purchase price is based, in part, on the net asset value of the target, the parties frequently agree to adjust the purchase price based upon a closing date balance sheet prepared after closing by accountants and according to accounting methods acceptable to the parties.

Acquisition Vehicle

Prior to making a U.S. acquisition, a Chinese acquirer should evaluate the ongoing structure of its U.S. operations and its U.S. growth strategy. There are several reasons why many foreign acquirers hold their U.S. operations through holding companies. For example, a holding company structure may be more appropriate when more than one U.S. acquisition is contemplated and subsequent acquisitions should not be subsidiaries of earlier acquired U.S. companies. In addition, if inter-company loans are used to finance the U.S. acquisition or ongoing operations, interest on such loans can be paid to a number of countries free of U.S. withholding taxes. Many U.S. holding companies are incorporated in Delaware due to a relatively favorable corporate tax regime, a flexible corporate law regime, a well developed body of corporate case law and a knowledgeable and expedient judiciary.

Choosing a Structure

There are a number of factors to consider in selecting an appropriate deal structure including: general strategic, business or financial issues affecting the acquirer or seller; a particular desire or need to segregate assets or allocate liabilities; the role of shareholders and the need for consents and approvals; and the application of certain regulations to the deal. The most significant consideration in structuring an acquisition is often taxation status, as discussed in greater detail below.

Whether or not (and to what extent) any of these factors will play a role in determining the ultimate structure will depend on the particular context of the parties to the transaction and the dynamics of the deal. In many cases, the acquirer and seller have differing (and often opposing) interests to consider and resolve to get a deal done.

TAX CONSIDERATIONS

The tax consequences of structuring a transaction as an asset versus share acquisition can vary considerably for both the acquirer and the seller and can play a large role in the negotiation of any deal. Generally, an asset acquisition offers two main advantages over a share acquisition for a Chinese investor: (i) a step-up in basis of the acquired assets to fair market value and (ii) additional post-acquisition flexibility for organizational tax planning. These tax advantages, however, come at potential cost to the seller. If the seller is a corporation, it can be exposed to two levels of tax on the transaction: first, at the corporate level, as the assets are sold and, second, at the shareholder level, if the sale proceeds are distributed to the shareholders. Depending on the seller, the seller's tax considerations may mandate a share acquisition. Note though that in today's economic environment there may actually be a basis decrease as a result of an asset sale because the value of assets may actually be below their tax basis and the seller may have a loss.

In a share acquisition, the sellers pay only one level of tax on the gain on sale. In the case of an individual, its capital gain is currently taxed at a preferential rate of 15% for assets held for more than one year as opposed to a maximum federal rate of 35% on ordinary income. Conversely, the buyer will generally not be able to fully depreciate the target's underlying assets to the extent of the purchase price (and thereby reduce its taxable income on a going-forward basis) since the buyer's historic tax basis to the assets will carry over in the acquisition. Certain other elements of the target's tax history would also carry over unaffected by the acquisition. However, the use of certain attributes such as the excess of basis over fair market value and net operating losses may be limited following an acquisition.

In certain circumstances, an acquirer may be able to obtain some of the benefits of an asset acquisition even though shares of the target have been purchased by making one of two elections of section 338 of the Internal Revenue Code of 1986, as amended (the "Code"). These elections are the functional equivalent to an asset purchase and may be desirable depending on the tax characteristics of the acquirer and seller.

The Chinese acquirer should also consider what measure of its income is subject to tax in the United States and in which manner after the acquisition of the target. Its taxation will depend on various factors, including, but not limited to, the entity that is chosen to make the acquisition, which investments are held by or through the United States target and the applicable tax rules in China.

Regulatory Approvals

ANTITRUST APPROVAL

The Hart-Scott Rodino Antitrust Improvements Act of 1976 (the "HSR Act") generally requires pre-notification to U.S. antitrust regulatory authorities. In general, there are two thresholds that must be satisfied before a transaction is reportable under the HSR Act — the "size of the persons" test and the "size of the transaction" test. An acquisition is reportable if it involves: (i) a person on one side of the transaction with $130.3 million or more in annual net sales or total assets and a person on the other side of the transaction with $13.0 million or more in annual net sales or total assets (the "size of persons" threshold); and (ii) the acquisition of voting securities or assets of the seller, or any combination of the seller's assets or voting securities, valued at more than $65.2 million (the "size of the transaction" threshold). Transactions valued at more than $260.7 million are reportable regardless of the size of the persons involved in the transaction. Certain exemptions may apply to the transactions including specific exemptions applicable when a non-U.S. company is involved in the acquisition. The HSR Act imposes a 30-day waiting period after notification by the acquirer and the target before the acquisition may be effected (plus 30 days from completion of submission of additional information, if requested). In the context of a cash tender offer, the waiting period is 15 days after notification by the acquirer (plus ten days from completion of submission of additional information, if requested). If the requested information is submitted promptly, antitrust clearance should not slow down the acquisition unless there is a real antitrust issue. As a practical matter, the HSR Act will not impede an acquisition of a U.S. company by a Chinese acquirer where the acquirer does not have other significant business in the United States. In that situation, the statutory waiting periods probably will be accelerated.

EXON-FLORIO

The Exon-Florio foreign investment law empowers the President of the United States to halt or rescind acquisitions by foreign acquirers of U.S. companies where the acquisition would threaten to impair the national security[1]. The President delegated this authority to the Committee on Foreign Investment in the United States ("CFIUS"). Acquisitions subject to Exon-Florio include any form of transaction in which the foreign acquirer achieves functional control over the U.S. target, whether by acquisition of shares or assets or by contractual arrangements, such as joint ventures, in which the U.S. target contributes an existing identifiable business in the United States.

1 See Section 721 of Title VII of the Defense Production Act 1950, as amended, commonly known as Exon-Florio (50 U.S.C. §2170), and the National Industrial Security Program established by Executive Order 12829 of January 6, 1993, Exec. Order No. 12,829, 58 Fed. Reg. 3479 (1993), *as amended*, 58 Fed. Reg. 65,863 (1993).

Parties to prospective transactions that might have national security implications typically submit joint voluntary notifications to CFIUS in advance of the closing of such transactions. Although these notifications are generally voluntary, failure to notify CFIUS may be cause for rescission of a completed transaction if CFIUS concludes that the national security is impaired. Notifications are mandatory for "foreign government controlled transactions," which are transactions subject to CFIUS review that "could result in control of a U.S. business by a foreign government or a person controlled by or acting on behalf of a foreign governments," including sovereign wealth funds.

Although CFIUS clears most reviewed transactions at the end of a 30-day review period, CFIUS will extend the 30-day period by an additional 45 days for (i) a transaction which threatens to impair national security and that threat has not been mitigated prior to the conclusion of the initial 30-day period, (ii) any "foreign government-controlled transaction" and (iii) any transaction that would result in foreign control of critical infrastructure. CFIUS may impose mitigation measures on the parties as a condition to approve the transaction, such as entering into a national security agreement with a CFIUS agency or providing a letter of assurance to CFIUS. If the transaction is not cleared by CFIUS by the end of that 45-day investigation period, CFIUS may decide to submit the transaction to the President, who has 15 days to determine whether to permit or prohibit the acquisition. Parties are encouraged to confer with CFIUS in advance of a formal notification, so that CFIUS can understand the transaction and provide guidance as to the information it will need to conduct the examination.

CFIUS identifies "national security considerations" (i.e., facts and circumstances that have potential national security implications) to assess whether a transactions poses a potential "national security risk" (i.e., whether the foreign acquirer that exercises control over the U.S. target as a result of the transaction might take action that threatens to impair U.S. national security). In conducting its analysis of whether a transaction poses a national security risk, CFIUS conducts a two-pronged test: (i) whether the nature of the U.S. business being acquired creates susceptibility to impairment of U.S. national security (i.e., whether there is a "vulnerability") and (ii) whether the foreign acquirer has the capability or intention to exploit or cause harm (i.e., whether there is a "threat"). "National security risk" is a function of the interaction between threat and vulnerability.

In December 2008, the U.S. Treasury Department, chair of CFIUS, published the "Guidance Concerning the National Security Review" (the "Guidance"), which provides a detailed description of the types of transactions CFIUS has reviewed that have presented national security considerations. Although the Guidance does not purport to identify the types of transactions that pose national security risks, it does help potential foreign investors to better assess the national security risk of a proposed transaction based on the characteristics of the U.S. target and the nature of the foreign investor. Chinese companies (whether or not state owned enterprises) that are interested in acquiring U.S. businesses may use the Guidance to help them select acquisition targets and better manage the CFIUS review process.

OTHER APPROVALS

In addition to the antitrust and foreign investment filings described above, additional filings, hearings and/or clearances may be required if the target's business is in an industry section which is subject to additional regulatory supervision (such as defense, banking, insurance, telecommunications and broadcasting, energy, and transportation and shipping).

Practical Tips for Chinese Acquirers Relating to Exon-Florio Reviews

- Be prepared for intensive CFIUS examination if the target is in industries such as defense, energy and natural resources, aerospace, transportation, telecommunications, and advanced technology.
- Be prepared for intensive CFIUS examination if the target has contracts with governmental agencies or conducts activities subject to U.S. export controls are also more likely to raise CFIUS concerns.
- Demonstrate, if the Chinese acquirer is controlled by, or otherwise connected with, the Chinese government, that it is independent of the government in terms of management and investment decisions (e.g., having independent directors, having investment policies based solely on commercial grounds, avoiding government subsidized acquisition financing, etc.).
- Engage legal advisors to develop a comprehensive legal and political strategy to address potential CFIUS concerns, to anticipate and address potential opposition at federal or state levels, and to identify and nurture potential allies.
- Consult with CFIUS as early as possible regarding the proposed transaction and be prepared to adjust the structure of the transaction based on such consultations.
- Particularly if the transaction is likely to be controversial, engage public relations advisors and explain as early as possible to the relevant audience in the U.S. the purpose of the acquisition, the acquirer's investment objectives, institutional and financing arrangements, relevant financial information, and plans for the U.S. business after acquisition.

The Acquisition Process — Documenting the Deal

Corporate acquisitions of any size, even straightforward ones, involve considerable legal documentation and negotiation. The major tasks for the acquirer, its lawyers and its accountants are:

- reaching agreement with a financial adviser, if one is to be used;
- negotiating the basic terms of the acquisition and formalizing them in a letter of intent (although a formal letter of intent is not always utilized);
- conducting a due diligence investigation of the business to be acquired;
- negotiating and drafting the definitive purchase agreement;
- negotiating and drafting supporting documents;
- seeking necessary approvals;
- preparing for closing; and
- conducting the closing.

FINANCIAL ADVISORS

In reaching agreement with a financial advisor, the issues of most interest to an acquirer are typically the compensation and indemnification provisions, although there may be little room to negotiate on the financial advisor's standard indemnification terms. The employment of an investment bank is a particularly good idea if the acquirer is entering the U.S. market for the first time, the available targets are not known, the acquirer needs advice on price, or the target itself is represented by an investment bank.

LETTER OF INTENT

Once a target company has been identified and approached and the parties have agreed in principle to the essential terms of the transaction, they typically execute a non-binding letter of intent. The letter of intent is usually not binding as to the ultimate consummation of the acquisition, but customarily sets out the proposed principal terms of the transaction and the parties' agreement to negotiate in good faith a definitive agreement to give effect to these terms (typically accompanied by a binding agreement to a period of exclusivity) as well as a binding agreement to maintain confidentiality. A letter of intent is not an essential step in a U.S. acquisition and, unless exclusivity is important to the acquirer, letters of intent are often skipped in favor of moving directly to the definitive documentation. In such a case, the parties typically sign a separate confidentiality agreement at this stage to allow the acquirer's purchase investigation to begin.

PURCHASE INVESTIGATION

Once a letter of intent or confidentiality agreement is signed, the acquirer often conducts a legal and financial investigation (a so-called "due-diligence" investigation) of the target's business. In connection with such an investigation, the acquirer asks the seller to provide it with information about the target's business (including detailed information about its operations, real property,

personal property (including patents, trademarks and other intellectual property), environmental matters, employee benefit plans, financial condition, litigation, and tax filings), and to provide it with copies of the relevant material documents (including corporate and organizational records, insurance policies, supply contracts, employment and labor contracts, employee benefit plans, leases, debt agreements, licenses, tax returns and informational filings and, if applicable, SEC filings). The acquirer, its lawyers and its accountants review these documents and information, as well as any other information they can obtain about the company or business, to determine if there are any legal, financial or other problems with the company or business and to learn as much about the target company as possible. If the target is a public company with recent financial statements certified by reputable accountants, the purchase investigation may be limited to available public information and if any additional purchase investigation is agreed to at all, it is likely to be short.

The acquirer's ability to conduct a purchase investigation and/or to obtain detailed representations and warranties and indemnification will depend, at least in part, on the nature of the seller and whether there is competition for the target. If the seller or its investment bankers are auctioning the business, a "data room" is typically set up by the seller and an acquirer's opportunity to conduct its investigation of the target beyond a controlled review of the data room may be limited in practice. In the U.S. many data rooms are "virtual" with all relevant information being accessible by potential acquirers remotely through on-line computer access.

PURCHASE AGREEMENT

The purchase agreement sets out the basic terms of the transaction (i.e., what is to be sold and the price to be paid). Particularly in an asset sale, it should specifically and carefully describe the assets to be transferred and the liabilities to be assumed and should also set forth how the purchase price will be allocated among the assets. This allocation will determine, in part, both the taxation of the seller in the transaction and the taxation of the acquired business after the transaction.

Typically, the seller makes extensive representations and warranties to the acquirer, including with respect to (i) the due incorporation and valid existence of the target company, (ii) the seller's authority to enter into the transaction, (iii) the capitalization of the target company, (iv) the accuracy and completeness of the financial statements and other documents given to the acquirer by the seller, (v) contingent and other liabilities, (vi) the target company's title to its assets, (vii) due payment of its taxes, (viii) absence of litigation and governmental investigations, (ix) environmental matters, (x) compliance with pension and related employee benefit matters, (xi) necessity for consents to the transaction, (xii) absence of defaults under existing agreements, (xiii) intellectual property matters, and (xiv) absence of burdensome provisions in existing agreements. Other warranties may be required, depending on the nature of the target's business and other facts unique to the transaction. The exact scope of these representations is typically subject to considerable negotiation. Unless the

acquirer is paying for the acquired business with its own shares, its representations and warranties are typically minimal.

The purchase agreement also typically sets out various covenants of the seller and the acquirer. One of the most important covenants made by the seller concerns the operation of the acquired business during the period between the signing of the purchase agreement and the closing. In addition, the purchase agreement sets out conditions to the obligations of the parties to complete the transaction. Depending upon the ownership structure of the target, the purchase agreement may also contain non-compete provisions restricting key owners from competing with the target business in the future. In a U.S. deal, acquirers customarily make their obligation to proceed with the acquisition contingent on the truth and accuracy of the seller's representations and warranties, the performance of the seller's covenants, the absence of litigation and other material proceedings, and the absence of material adverse changes in the seller's financial condition or business.

The acquirer may seek to make its obligation to complete the acquisition contingent upon satisfactory completion of its purchase investigation. Sellers are often very resistant to such a provision as it can be viewed as providing the acquirer with an option on the deal and creates real uncertainty for the seller on the terms of the transaction and whether or not closing will actually occur. While retaining flexibility for itself, the acquirer seeks to commit the seller to the transaction as firmly as possible. Because the parties' obligations to complete the transaction may be contingent on obtaining necessary approvals and consents, it may be difficult or impossible to commit the seller completely.

ANCILLARY DOCUMENTATION

Other documents required to complete an acquisition can be extensive, and may include employment agreements with key employees; non-competition agreements with principals leaving the business; transition services agreements to address potential business separation issues; a merger agreement if the purchase of shares will be followed by a merger of the acquired corporation with the acquirer or a subsidiary of the acquirer; deeds, assignments and other transfer documents in the case of an asset sale; certificates of the seller regarding important representations and warranties; consents of major suppliers, governmental agencies, major creditors, landlords and others; resolutions of the boards of directors of the corporations and their shareholders; a "cold comfort" letter from the accountants of the seller regarding their investigation of the target business; an escrow agreement if any of the purchase price is placed in escrow; receipts for money paid at the closing; and promissory notes representing a portion of the purchase price.

With respect to the acquisition of a U.S. public company, additional documentation required may include tender offer documents, proxy statements, registration statements, and other materials that might need to be filed with the SEC and/or submitted to the target's shareholders. Certain special considerations relating to the acquisition of public companies are summarized below.

U.S. Public Company Acquisitions

Acquisitions of U.S. public companies are customarily effected through either a negotiated merger or a tender offer made directly to the target's shareholders.

MERGERS

To effect a merger, the two companies negotiate a merger agreement. On the effective date of the merger, the target's shares are automatically converted into the right to receive the consideration specified in the merger agreement (whether cash, shares of the acquiring company, a combination of cash and shares or another form of consideration). Such a merger will usually require the approval of the shareholders of the target company and, depending on the structure of the transaction, and whether the acquirer is issuing a considerable amount of shares in the acquisition, may sometimes require the approval of the shareholders of the acquirer as well. Under SEC rules, information (in the form of a "proxy statement") must be sent to shareholders before seeking such approval and must be filed in advance with the SEC. The proxy statement is usually the subject of a lengthy review process by the SEC's staff. Generally, the SEC's proxy review process will occur concurrently with the process for other regulatory clearances. If securities of the acquirer will be issued as consideration in the merger, a registration statement generally (which would generally be combined with the proxy statement) also must be filed with and reviewed by the SEC. Assuming no other regulatory constraints, it can be expected to take about 90 to 120 days from the date of signing to close the merger. This straightforward arrangement is usually the structure of choice for negotiated combinations in which the consideration to be paid to the target's shareholders consists of shares or other securities of the acquirer. An acquisition through merger can be structured in a variety of different ways depending on a number of factors including tax, legal and regulatory considerations.

TENDER AND EXCHANGE OFFERS

As an alternative, the acquiring company may gain control of the target by making a tender offer for some or all of the target's shares followed by a "squeeze-out" merger of the non-tendering shareholders, usually at the same price. If the transaction is supported by the target, the parties will negotiate and enter into a merger agreement, as discussed above, which will govern the tender offer process and the second step merger as described below. The consideration payable in either step can be cash, shares of the acquiring company or other consideration. A tender offer for a consideration other than cash is referred to as an exchange offer. If cash will be used as all of the consideration, the use of a tender offer can have a significant advantage in speed over the merger structure described above. A cash tender offer does not require prior review by the SEC and, barring regulatory constraints or unforeseen circumstances, the tender offer can be closed as early as 20 business days (the statutory minimum offer period) after being commenced. At that time, the acquirer usually purchases enough shares in the target to assure its ability to approve a subsequent second-step merger, thereby obtaining ownership of 100% of the target's shares. If the acquirer can

acquire more than 90% of the outstanding shares of the target in the tender offer, it will usually have the power under the applicable state's laws to approve the second-step merger immediately and without a shareholders' meeting. Thus, the entire acquisition can be consummated in about five or six weeks. If the acquirer proposes to use shares or other securities as consideration in an exchange offer, there will be timing implications for the transaction. Securities issued in an exchange offer have to be registered with the SEC before the transaction can be consummated. Since the SEC registration process can take 60 to 90 days, an exchange offer has only a modest timing advantage, if any, over the merger structure described above.

Tender offers for US companies (and non-U.S. companies with U.S. based shareholders) are regulated under US securities laws and regulations. These laws and regulations seek to ensure public disclosure of material information to the target, its shareholders and the marketplace during tender offers, as well as to impose procedural and substantive requirements on tender offers to ensure that shareholders receive fair treatment. The offer normally consists of a bid by an individual or group to buy shares of a company — usually at a price above the current market price. Those accepting the offer are said to tender their shares for purchase. The entity making the offer obligates itself to purchase all or a specified portion of the tendered shares if certain specified conditions are met.

A clear disadvantage of exchange offers as compared to mergers is that the bidder typically would need to acquire at least 80% of the target's share in the exchange offer in order to assure that the exchange offer is not taxable to the target's shareholders. Even then, a second-step merger would be needed to eliminate the shareholders who, inevitably, fail to tender their shares. A merger, in contrast, typically requires a simple majority vote to be approved and, once approved, is binding on all shareholders, subject to any appraisal or "dissenters'" rights that may be available. Since the exchange offer provides added complexity and little or no advantage in speed, a straightforward merger transaction is still the preferred method in most negotiated transactions where shares or other securities are used as consideration.

Although a discussion of hostile takeovers is beyond the scope of this article, if an acquirer fails to open negotiations with target management or their discussions fail to reach agreement on a transaction, several means are available to increase pressure on target management to consider a bona fide acquisition proposal. While such "hostile" actions will likely strain relations between an acquirer and its intended target, the fiduciary duties of target's management generally preclude it from ignoring entirely a proposal that can increase value for its shareholders. These methods include "proxy fights", "bear hugs" and litigation.

The tender offer materials which will be distributed to all of the target's shareholders must include certain disclosures about the transaction, the target and the bidder as required by the SEC's tender offer form, the Schedule TO. Much less information is required to be disclosed about the bidder in a cash tender offer than would be required in a sale of securities by the bidder through an exchange offer. Generally, the information disclosed about the bidder in cash offers is limited to the names and five-year employment histories of the officers and directors of the bidder, as well as those of any person or entity controlling the bidder, a brief description of the bidder and its business and certain financial information. Information must also be disclosed about the source of financing for the offer. If the tender offer is being financed other than out of the bidder's available cash resources, detailed information is required about the financing arrangements, including detailed summaries of loans and other borrowing arrangements. In addition, a description of the history of negotiations between the target and the bidder, and any other parties that may have been involved, is an important part of the tender offer disclosure as well.

The U.S. tender and exchange offer rules are complex and to minimize the risk of non-compliance, a Chinese acquirer considering a possible takeover of a U.S. public company should consult with U.S. legal counsel in advance of any acquisition. It should also be noted that the U.S. system of tender offer regulation applies to all tender offers made "directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise" and can apply to offers to acquire shares from U.S. shareholders of non-U.S. companies.

PUBLIC MINORITIES

Acquisitions may be made cheaper by leaving a public minority in place, but the bargain may be illusory for a number of reasons. A public minority may make the economies that are the main purpose of the acquisition difficult or impossible to achieve. The public minority imposes fiduciary duties upon a majority shareholder that may hinder its exercise of control, and the presence of a public minority gives management an excuse not to do what the majority shareholder wants. With a public minority in place the target may also have continuing SEC disclosure and other obligations and must continue to comply with the Sarbanes-Oxley regulatory regime. In addition, the costs of buying out the minority later on may be high. For these reasons, certain deals that left public minorities in place, have provided for the ultimate purchase of the minority shareholdings at prices determined pursuant to preset formulae which take into account share value appreciation. The continued presence of minority shareholders makes it significantly more difficult for an acquirer to combine and restructure its and the target's businesses, assets and liabilities in an optimal way, because of potential claims by the minority shareholders of conflict of interest (including breach of fiduciary duty or usurpation of corporate opportunity).

DEAL PROTECTION

Competition is always a possibility in acquisitions of public companies. This is because the target's shareholders will either vote against a negotiated merger if a better offer has been announced or, in a tender or exchange offer context, refuse to tender their shares. There is inevitably a delay between disclosure of the negotiated deal and its consummation, which provides time and a free education to competing bidders — two crucial ingredients to their potential success. An acquirer can adopt several strategies to improve its ability to enforce its negotiated acquisition agreement with the target, including entering into contractual "lock-ups" of the target shares with large shareholders. There is no perfect strategy and, as a general rule, the tighter the lockup, the less likely it is to be enforceable. There are, however, myriad techniques that acquirers can employ to minimize the risk in this regard and to provide the acquirer with some compensation if a topping bidder emerges.

PUBLIC DISCLOSURES AND PRESS ANNOUNCEMENTS

There is generally no affirmative duty to disclose merger discussions except to the extent that a party to the negotiations has an obligation to report under applicable SEC rules and regulations, or where the parties become concerned about the possibility of insider trading occurring as a result of the non-disclosure of the material information. Both targets and acquirers typically maintain a "no comment" stance with the press until they are prepared to truthfully announce the status of negotiations. This will be of great importance to the target's board as the board of a U.S. public company may be liable to it's shareholders for misleading investors about the existence or non-existence of discussions regarding mergers or other extraordinary events. If the confidentiality of a transaction can be maintained, the bidder gains the tactical advantage of keeping potential rival bidders uninformed until the bidder is prepared to launch a cash tender offer or offer securities to the target's shareholders. Once an agreement with respect to a merger or other business combination is reached, press releases announcing the essential terms of the agreement will typically be made by both parties.

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