



2019
MERGERS & ACQUISITIONS
HELPFUL CHECKLISTS

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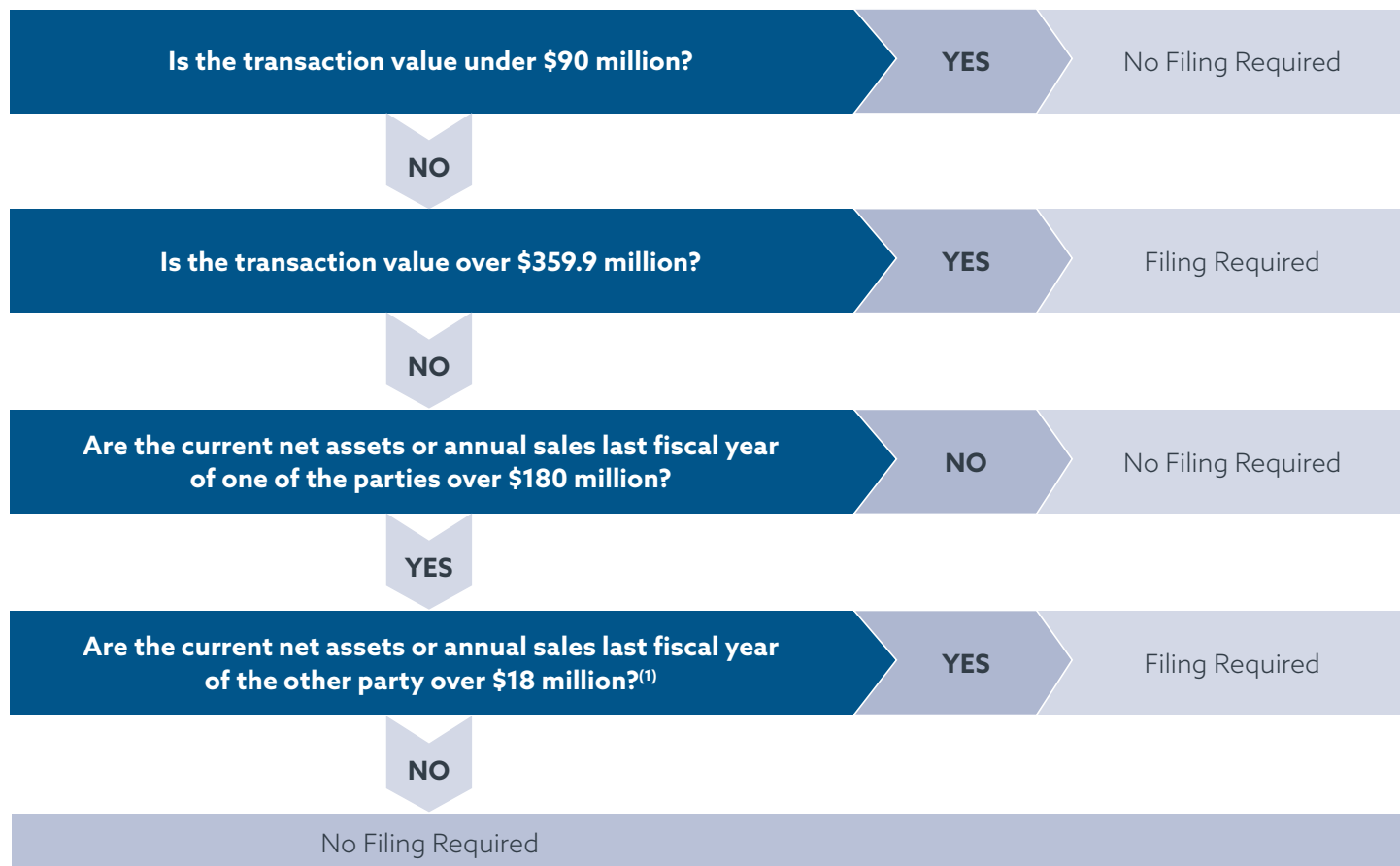
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Disclaimer: These truncated checklists are for convenience only prior to consulting legal counsel, are not legal advice, do not create an attorney-client relationship. The reader should consult legal counsel about any information contained herein. Laws differ by state. Tax matters are inherently complex and depend on specific facts, code provisions and regulatory interpretations. These checklists are solely intended to spark inquiry and thought and are not definitive.

U.S. Antitrust Considerations

Hart-Scott-Rodino (HSR) Notification Flowchart



⁽¹⁾ Note: If Buyer is not engaged in manufacturing and has at least \$180 million in current net assets or annual sales last fiscal year, then filing required only if Target's current net assets equal or exceed \$18 million.

These are general rules of thumb; HSR contains multiple important exemptions that can be explained by an HSR expert.

HSR Filing Fees

Transaction Value	\$90 – \$180 million	At or above \$180 – \$899.8 million	At or above \$899.8 million
Fee	\$45,000	\$125,000	\$280,000

Tax Structuring

Maximum Cash Component For Tax-Free Reorganization (Tax Deferred On Stock Component)

Structure Name	Tax Code Section	Cash	Stock
Reverse Triangular Merger	368	20%	80%
Forward Merger	368	60%	40%
"Double Dummy"	351	No Limit	

Certain Other Tax Planning Considerations

"Stock Purchase"

- Pre-closing tax basis in assets is carried over; no step-up in tax basis. Reverse triangular mergers, without a 338(h)(10)/336(e) election, treated as such.

"Asset Purchase"

- Pre-closing tax basis in assets is increased/stepped-up to deal purchase price. Future Buyer deductions thus increased; Target pays tax on gain.

Section 338(h)(10)/336(e) Election

- Optional election when purchasing a C corporation from an affiliated group, or an S corporation. Treats stock purchase as an asset purchase, allowing step-up in tax basis.

Forward Merger Caution

- In a taxable transaction, a forward merger is treated as an asset purchase, thereby triggering taxation at both corporate and stockholder levels. Thus, used only in 'tax-free' reorganizations.

Cash Always Taxed

- Cash (aka "boot") is *always* taxable, even in 'tax-free' transactions. "Tax free" really means "tax deferred" for stock consideration (and if cash exceeds gain, there is no deferral).

Significant Legal Due Diligence Areas

Corporate

- Certificate of Incorporation; Bylaws
- Subsidiaries/goodstandings
- Capitalization/financings
- Option plans/RSU's/warrants
- Prior mergers and acquisitions

Agreements

- Customers
- Suppliers; manufacturing
- Loans/Equipment leases

Intellectual Property

- Registered: Patent, trademark and copyright
- Assignment of inventions agreements
- Inbound/Outbound IP licenses
- Open source and code quality

Data Privacy Policies

- General Data Privacy Regulation (GDPR) (EU)
- California Consumer Privacy Act (CCPA)
- Protected categories/regimes: PII, PHI/HIPAA, PCI/payments

Human Resources

- ERISA/401(k) filings/benefit plans
- Pension obligations
- Employment agreements
- Terminations/severance; Claims history
- Labor relations

Tax

- Federal, state and foreign returns
- Sales/use tax
- Audits
- International tax/transfer pricing

Cybersecurity

- Breach history
- Incident response plan; Tabletop exercise reports
- Vulnerability and risk analyses

Environmental

Trade Compliance

- Export Control (ITAR/EAR): Classification; Licenses; Deemed exports
- Sanctions Compliance Program: OFAC; BIS; Other

Foreign Corrupt Practices Act/ UK Anti-Bribery Act

Insurance

Litigation

Real Estate

Common M&A Deal Terms

Non-Disclosure Agreement (NDA or "confi")

- **Purpose:** Potential of a 'backdoor standstill'
- **Definition of Confidential Materials:** Marked vs. unmarked; deemed; oral; carve-outs
- **Representatives:** Liability standard for representatives' conduct
- **Exclusivity:** Length. Auto-extensions?
- **Non-Solicit/Non-Hire**
- **Standstill:** Duration and proscribed activities (public Target)
- **Standstill: Don't Ask/Don't Waive:** Non-public exception and/or fall-away upon a deal signing (public Target)
- **Anti-Clubbing:** No inter-bidder coordination without Target consent
- **Financing:** No financing exploration without Target consent
- **Control:** Bidder communication with Target exclusively through designated Target personnel
- **Term:** Often two years, but can extend to three years.
- **Dispute Resolution:** Forum; choice of law.

Merger vs. Stock Purchase vs. Asset Purchase

Valuation Levers

- Options/RsUs/Warrants, including any accelerated or roll-over vesting and option exercise proceeds
- Treatment of Cash, Debt

Stock as Consideration

- **Fixed shares or Fixed Value:** Floating vs. fixed exchange ratio
- **Collar(s):** Floor; ceiling. Double trigger for external events?
- **Walk Right:** Does Target have unilateral walk right if Buyer share price falls below specified floor?
- **Fill or Kill:** If unilateral walk right trigger enabled, can Buyer still elect to top-up number of shares to floor, a.k.a. fill-or-kill?

- **Cash/Stock Mix:** Cash/stock election and associated limits on each form of consideration?
- **Unaccredited Investors:**
 - Cash out entirely; or
 - Accept up to 35 unaccredited investors, but each must each meet sophistication requirements either alone or with a purchaser representative; or
 - 3(a)(10) state 'fairness' hearing (California; rare); or
 - File registration statement (expensive and time burden)
- **Revesting Stock:** If an employee is required to revest stock, risk that requirement of continued service recharacterizes tax treatment as ordinary income.

Post Closing Working Capital Adjustment (private Target)

- One-way or two-way
- Separate escrow?

Contingent Consideration (Earn-out) (private Target)

- Amount/term
- What efforts must Buyer exert?
- Indemnity set-off

Non-Compete Provisions (private Target)

- Non-compete and non-solicitation term
- Definition of excluded business

Covenants

- Pre-closing operating restrictions on the business; flat or qualified by reasonable efforts
- Post-closing directors and officers insurance "tail policy" — customarily 6 years plus premium cap at up to 300% current annual amount

Antitrust/Competition

- Hart Scott Rodino/Antitrust notification required? Foreign filings? 'Immaterial' jurisdictions?
- 'Hell or high water' vs. 'Best efforts'; Duty to make divestitures?

Conditions to Closing

- Customer, landlord or bank consent?
- Other regulators

Termination

- Outside date; auto-extensions?
- Termination right if Target does not have stockholder approval by fixed time?
- Break-up fee/Expense reimbursement
- Is the break-up fee and expense reimbursement the sole and exclusive remedy to Buyer upon Seller termination for a superior proposal?
- Reverse break-up fee (often antitrust or Buyer financing)

Indemnity (private Target)

- Rep and warranty insurance
- Escrow vs. holdback
- General indemnity cap; is indemnity limited to escrow/holdback amount?
- Basket vs. deductible
- Reps & warranties survival period and cap amount
 - "General" reps & warranties
 - "Fundamental representations"
 - Authorization, good standing, capitalization
 - Tax, employee benefits
 - Intellectual property ownership/ infringement
- Materiality Scrapes
 - Single Scrape: Once breach is determined, removes materiality qualifiers for purposes of determining damages.
 - Double Scrape: Eliminate materiality qualifiers in evaluating both breach and resulting damages.
- Mini-Baskets
- "Knowledge": Constructive or actual standard? Specified individuals.
- Anti/pro-'Sandbagging'
- 10b-5/full disclosure rep?
- Stock and Asset Purchases vs. Merger: Challenges with mergers and joinders for post-closing stockholder liability.

Choice of Law

Common M&A Workstreams

- **Legal:** Definitive documents and due diligence
- **Tax:** Structure and due diligence; domestic and cross-border
- **Regulatory:** Competition/antitrust landscape and industry-specific regulators
- **Communications:** Stockholders, customers, suppliers, employees & general PR
- **HR:** Offer letters, collective bargaining, benefits optimization (FICA withholding, etc.)
- **Finance:** Accounting definitions in agreements; working capital levels; business analysis
- **Transition Services:** For asset divestitures
- **Integration/Post-Closing Team:** Cross-disciplinary drawn from above

Public Company Target Considerations

- **Two Available Structures:**
 - Statutory merger ('one step transaction') effected through a special meeting of company stockholders and filing of a merger certificate (first and only step), or
 - A tender offer ('two step transaction') where an offeror directly purchases shares from stockholders (first step) and then effects a merger on the back-end to gain 100% ownership (second step).
- **Speed to Control:** In deals without need for extended sign-to-close period, initial (first) step in tender offer can close in in 20 business days from launch (roughly 30 calendar days if filing preparation required post-signing), vs. 60-90 days for statutory merger given need for SEC pre-review.
- **Certainty of Control:** For extended sign-to-close transactions, however, where significant third party approvals (such as antitrust) may be required, a one-step merger may be speediest path to a stockholder vote. Stockholder approval, even well prior to actual closing, eliminates a fiduciary out for superior proposals and thus then precludes third party would-be interlopers.
- **Form of Consideration:** Tender offer speed in practice useful only when for all-cash transaction. Any stock must still be registered with the SEC.
- **'Squeeze Outs' & Time to 100% Ownership:**
 - Delaware law has always allowed tender offerors who close the tender offer with 90% or greater share ownership to immediately file a **'short form' merger** so long as the remaining stockholders received deal price.
 - The goal to get to 90% prompted the **'top-up option'** where if an offeror hit usually between 80-90% ownership (often 85%+) then the subject company allowed exercise of an option (where the exercise cash was quickly roundtripped post-closing, making it essentially an artifice) for the offeror to immediately reach 90%. Offerors who gained more than 50% but short of a top-option threshold (e.g. 85%) would have to hold a special stockholder meeting for the second step minority squeeze-out merger, including filing an SEC proxy statement, even though the outcome of the meeting was a foregone conclusion because the offeror held sufficient votes to approve on its own.
- Since 2014, however, DGCL Section 251(h) has provided for a **'medium form' merger** where an offeror who gains at least 50% ownership in the tender offer can immediately effect a squeeze out merger without a special stockholder meeting. This eliminates contortions of top-up options or waiting another approximate 60 days for a non-substantive special stockholder meeting.
- **Disclosure:**
 - **Competing Bidders:** Both principal disclosure forms (Schedule 14D-9 in tender offer and proxy statement in one-step merger) require Target to disclose any negotiations with third party bidder(s).
 - **Acquisition Agreements:** Must have appropriate disclaimers disavowing that reps and warranties are to be relied upon as disclosure (*Titan*).
 - **All Public Communications:** Under Rule 425, must file all disseminated materials.
- **Trading:** Under Regulation M, if Buyer is using stock, during pendency of deal, no repurchases by Buyer or purchases by Target of Buyer's stock.

Fiduciary Duties in a Change of Control

Evaluating Transaction Structure: Price, Process And Contract Terms

Price:

- **Amount of Consideration**
- **Form of Consideration:** Cash? Stock? Notes? Mix? Fixed, Floating or Collars?

Certainty of Consideration

- **Financing:** Does Buyer require financing and, if so, is there a financing contingency in the merger

contract? What form of assurance from financial institutions is to be provided prior to signing the merger contract?

- **Regulatory Factors:** Are there antitrust or specialized regulatory concerns that could prevent closing?

- **Buyer's Business:** If stock is part of consideration, how much "reverse" due diligence has Target performed on Buyer? What is Buyer's business outlook?

- **Contingent Consideration** ("Earn-Out") (private Target): What are Buyer's obligations to support/restrictions to affect Target business post-closing?

Process: Balance between pre-signing and post-signing reasonable assurance that price is suitable

Pre-Signing:

- **Market Check:** Did Target perform a selected or broad-based market check, or not?
- **Auction:** If actual auction of the business, was Buyer highest bidder?
- **Conflicts:** Was the process free of any conflicts of interest?

Post-Signing:

- **"Go Shop" Period:** Does the contract provide for a mandatory shopping period post-signing for Target to seek a better deal? Term sheet or fully negotiated merger agreement required? Bifurcated termination fee?

- **"Window Shop":** Does the contract allow Target to engage with inbound inquiries from third party bidders post-signing (more difficult to satisfy for small cap/lesser known companies)?

Contract Terms: Tension between complete certainty of consummation and asymmetric optionality

Target Optionality Post Signing

- **Superior Offer:** Does the contract allow for an immediate termination (with fee) if a superior proposal is offered by a third party post-signing?
- **Board Change of Recommendation:** Allowed whenever advisable or only for a superior proposal? Does adverse recommendation change by Target Board trigger Buyer termination right?
- **Force the Vote?** No immediate termination right for superior proposals;

only right of directors to change recommendation – deal must then go to Target stockholder vote.

- **Termination Fee:** Amount (generally 2.5-4.5%)? Tail period if either takeover proposal is made and outside date reached or acquisition consummated within certain period of termination?

- **Buyer Match Right** for superior proposal: Terms (updates)?

Buyer Optionality Post-Signing

- **Rep & Warranty Bring Down at Closing:** No Material Adverse Effect vs. "in all material respects"? Standard MAE carve-outs for Target?

- Are reps as of the date of signing, or forward looking to include sign to close period? If forward looking, updates required? Cure period allowed?

- Are reps knowledge qualified and what is definition of knowledge?

- **Consents:** Regulatory or customer/supplier?

Other Material Items

- **Reverse Break-up Fee:** (e.g. antitrust)

- **Termination:** Drop dead date? Auto-extension triggers?

- **Post-Closing Liability** (private Target)

Key Delaware M&A Legal Standards

General Standards

- **Business Judgment Rule:** Duties of good faith, loyalty and care. Objective standard of gross negligence for due care and prudence. *Smith v. Van Gorkom (1985)*
- **Enhanced Scrutiny:** Reasonableness and proportionality in evaluating responses to a corporate threat. *Unocal Corp. v. Mesa Petroleum Co. (1985)*
- **Revlon Duties:** Heightened duties to essentially pick the best probability-weighted price when sale or breakup is "inevitable." Board changes from "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. (1986)*
- **Entire Fairness Standard:** If Board fails at meeting standards, burden of proof shifts from plaintiff(s) to defendants to demonstrate how a breach of fiduciary duties did not occur. Objective evaluation of both fair dealing and fair price. *Weinberger v. UOP, Inc. (1983)*

What triggers Revlon?

Paramount Communications, Inc. v. Time Inc. (1989)

- **Auction:** Target commences an auction process; or
- **An Alternative Change of Control:** Target seeks an alternative change of control that has the effect of frustrating a bidder's efforts.

How large a cash component qualifies a deal for Revlon?

- A stock-for-stock negotiated transaction generally does not trigger *Revlon*.
- Cash as high as 33% of total consideration does not implicate *Revlon*. *Steinhardt v. Howard-Anderson (2011)*
- 50/50% cash/stock consideration in a contested bidder process probably does. *In re Smurfit-Stone Container Corp. S'Holder Litig (2011)*
- Over 60% cash component in a contested bidder process definitely implicates *Revlon*. *In re Lukens Inc. Shareholders Litigation (1999)*

Cleansing Conflicts

- **Controlling stockholder transactions:** Afforded the business judgment rule if (a) a fully functioning Board special committee independently negotiates the transaction using separately engaged advisors, and (b) uncoerced and fully informed approval by a majority of disinterested stockholders (majority of the minority). *Kahn vs. M.F. & Worldwide Corp. (2014)*
- **What is control?** A controlling stockholder either has 50% or greater interest, or has established disproportionate control/domination of the corporation. *In re: Tesla Stockholders Litigation (2018)*
- **Interested director transactions:** Business judgment rule applies if uncoerced and fully informed disinterested stockholder vote. *Corwin vs. KKR Financial (2015)*

Deal Lock-Ups

- **No Fait Accompli:** No fully locking-up transaction through pre-signing solicitation of stockholder consents or support agreements, which in turn makes stockholder solicitation/vote a foregone conclusion. *Omnicare, Inc. vs. NCS Healthcare, Inc. (2003)*
- **Permitted Lock-Up Level:** Delaware has permitted up to 35% of shares to be locked-up pre-signing. *In re Toys "R" US, Inc. Shareholder Litigation (2005)*
- **Ratchet Back Alternative:** Delaware has also permitted locking-up up to 40% of shares, but with a built-in trigger to 'ratchet back' to 33% or less if Board changes its recommendation. *In re Synthes, Inc. S'holder Litig. (2012)*
- **Sign and Consent:** For a private Target generally, Buyer may require balance of consents within 24 hours of signing. *In re OPENLANE, Inc. S'holders Litig. (2011)*

Tortious Interference Liability

When is an interloper at risk of a tortious interference claim? State common law claim: Requires a predicate of significant wrongdoing to then enable

a tortious interference cause of action. Examples of such wrongful conduct include unauthorized access to Target confidential information, material

omissions from public disclosure or colluding with Target to breach its non-solicitation contractual obligations.

Stockholder Rights Plans (“Poison Pill”) Basics

- **Adoption:** Board declares dividend of preferred stock purchase rights. To do so without stockholder vote, Board needs right of ‘blank check’ preferred stock in certificate of incorporation. Adoption of rights plan must be publicly disclosed/filed and Rights are registered with the SEC on a short form registration statement, the Form 8-A.
- **Trading:** Rights are attached to the common stock and thus automatically trade with such common stock unless/until the Rights detach via a “distribution date.” Such date is generally set as 10 business days following a triggering event, which allows both (a) a cure period for the Acquiring Person in case of inadvertent triggering and (b) a waiver period in the event the Board wishes to make an exemption.
- **Triggering Threshold:**
 - Acquiring Person threshold historically customarily set to 15%, mirroring Delaware Section 203.
 - Alternate formulation is to set a (a) lower threshold (e.g. 10%) for filers on Schedule 13D, who by definition have an intent to influence control, and (b) higher threshold (e.g. 20%) for filers on Schedule 13G who, again by definition, are passive investors.
 - Threshold should cover derivative instruments.
- **Delaware Section 203 Interplay:**
 - Delaware General Corporation Law Section 203 prohibits a merger for three years with any affiliate of a person acquiring 15% or more of a company’s stock unless either (a) a ‘non-interested’ offeror reaches 85% or greater ownership through a single transaction, such as a tender offer, or (b) the transaction is approved by 2/3 or greater of the ‘non-interested’ shares.
 - Section 203 does not in and of itself block a hostile takeover offer by an offeror who does not own 15% or more of a company’s stock; only a stockholder rights plan is effective in that regard.
- **Three Operative Mechanisms:**
 - **“Flip-In”:** Each Right allows the holder of common stock, other than the Acquiring Person, to purchase for the exercise price such number of shares of company common stock determined by (a) twice the exercise price divided, by (b) the common stock spot stock market price. Exercise price set as the long term expected trading value of the common stock during the term of the rights plan, often 3X-5X of current common stock price.
 - **“Flip-Over”:** After a change-of-control, allows acquisition of Buyer stock. Similar price mechanics to Flip-In. Permitted in Delaware, but not in many other states.
 - **“Exchange” provisions:** When Rights detach upon a triggering event, actual exercise of Rights requires discretionary investment decision by stockholders. For more automatic and less complex immediate dilution, exchange provisions provide the Board the ability to declare after a triggering event, and unless/until Acquiring Person owns 50% or more of company’s outstanding common stock, all outstanding Rights, other than those held by the Acquiring Person, be exchanged at a ratio of one share of common stock for each outstanding Right. Usually should result in less dilution than Flip-In provisions, but still materially dilutive to Acquiring Person.
 - **“Chewable” Pills:** Provides that a rights plan automatically will not be triggered by a “qualified offer.” Required characteristics of a qualified offer often include features such as a minimum premium, accompaniment of a fairness opinion, absence of financing contingency and/or minimum open offer period.
 - **Pressure to Rescind & No “Dead Hand” Restrictions:** Frequently, a Board will be pressured to rescind a rights plan. Moreover, following a proxy contest where an insurgent wins control of the Board, the new Board proactively may wish to rescind an existing rights plan. Delaware law prohibits a rights plan from containing “Dead Hand” restrictions at time of adoption that would prevent in the future a new Board from rescinding the rights plan.
- **“Reloading”:** If Rights triggered, Board can simply issue more preferred stock purchase rights.
- **NOL Rights Plans**
 - **Mechanics:** Virtually identical to general stockholder rights plan, except that Acquiring Person triggering threshold is lowered to 4.99% instead of, for example, 15%.
 - **Grandfathering/Exceptions:** Rights plans customarily grandfather in stockholders who already hold more than the proposed triggering threshold. Board also retains discretion to make exceptions for new entrants, but this can be area of increased risk.
- **Stakeholder Perception**
 - ISS and Glass Lewis, as well as major governance departments, oppose general adoption of stockholder rights plan. Consequently, rights plans are generally held ‘on the shelf’. Nonetheless, rights plans do require advance preparation, both for financial analysis, in order to set the exercise price which is usually done with a financial advisor, and legal drafting/provision selection.
 - Proxy advisory firms and governance departments have shown greater leeway towards NOL rights plans. For example, ISS evaluates NOL rights plans on a “case by case” basis so long as, at a minimum, there is a three year independent director evaluation (“TIDE” provision) or, preferably, the rights plan is put to the stockholders at the next annual meeting for ratification.

Tax and Acquisition Accounting Considerations

Golden Parachute Rules — Internal Revenue Code Sections 280G and 4999

- **What Is It?** Imposes a 20% excise tax on an individual (Section 4999), and loss of deduction for the company (Section 280G), on payments contingent upon the change of control in excess of an individual's base amount (see below), if the total contingent payments equal or exceed the 280G threshold.
- **Who Does It Apply To?**
 - Officers (up to 10% of the workforce or a minimum of 3);
 - the highest paid (top 1%); and
 - significant shareholders (holders of 1% or greater of the value of the company).
- **280G Threshold:** Means at or above 3X (300%) of average compensation, called the 'base amount', for the 5 calendar (tax) years prior to the change in control (or such shorter period of employment).
- **Equity Twist:** If granted within one year of the change-in-control, equity is presumed to be valued at its full value rather than just the accelerated portion thereof.
- **Private Company Cleansing:** For a private Target only, approval by more than 75% or greater in interest of unconflicted stockholders, in a vote separate from approving a change of control, cleanses entirely; provided that the individual puts the amount at risk (i.e., if not approved by the stockholders, then the amount at or above the 280G threshold is forfeited).
- **No Cleansing For Public Companies:** However, portions of payments may be considered 'reasonable compensation' for services on or after change of control, including a non-compete, and thus excluded. Highly fact specific.
- **Common Executive Formulations:** In executive compensation agreements, executive often may receive the 'better of' on an after-tax basis (a) 2.99X base amount or, (b) the full amount of change in control payments, net of the excise tax.
- **Gross-Ups:** Reimbursement provisions are strongly disfavored by proxy advisory firms but in practice, still can be introduced prior to change of control. Any gross-up itself becomes an 'excess parachute payment' subject to the excise tax/non-deductibility provisions, thus substantially increasing the aggregate gross-up amount.
- **Complex:** Area of the law that requires thorough tax analysis and guidance.

NOL Loss Carryforward Limitations

- **IRS Section 382:** Governs accumulated net operating loss carry-forwards.
- **Actual Change of Control:** Outright change of control materially impairs (virtually eliminates) NOL's. Prevents market for 'zombie' companies with NOL's.
- **Deemed Change of Control Test:** Absent an actual acquisition, the IRS applies a rolling, non-intuitive and complex test for 'churn' in a subject company's stock. If 5% or greater holders, aggregated as a group, in any rolling 3 year period acquire more than 50% of the value of stock than they already own when they become 5% holders, there is a deemed 'change of control' which results in material impairment but not virtual elimination of NOL's.
- **Rolling Level Can Fluctuate:** Generally tested annually. By definition, to avoid impairment, the level in a test may not reach 50%. Levels generally above 30% (and often lower) merit discussion and analysis of impairment risk and value to company.

Form 8-K and Offering Financial Statements

Significance Tests:

Reg S-X 3-05 and 1-02(w)

- **Investment Test:** Buyer's investment in Target as a percentage of Buyer's pre-closing total assets;
- **Asset Test:** Target's total assets as a percentage of Buyer's pre-closing total assets; and
- **Income Test:** Target's continuing operations pre-tax income as a percentage of pre-closing Buyer's continuing operations pre-tax income.

Practice Points (from SEC Financial Reporting Manual (FRM) Section 2015):

- **No Rounding:** Do not round the results of the significance tests.
- **Investment Test:** The numerator of the investment test for the purchase of an equity method investment should include transaction costs, consistent with accounting under ASC 323-10. The numerator should also include contingent consideration (on a gross basis) if the likelihood of payment is more than remote.

- **Asset Test:** Compare the most recent pre-acquisition annual financial statements of Target to Buyer's pre-acquisition consolidated financial statements as of the end of the most recently completed audited fiscal year required to be filed with the SEC.

Income Test:

- If Buyer's last year income is 10% or more lower than the preceding year, then Buyer income should be a five year trailing average. Target income can never be averaged.
- If Buyer reported a loss, Buyer should compare the absolute value of its reported loss to its average income for the last 5 fiscal years to determine if Buyer is required to use average income.
- If averaged, any Buyer loss years should be assigned a value of zero in computing the numerator but the denominator remains "5".

In the case of a single acquisition, if either Buyer or Target reported a pretax loss and the other entity reported pretax income, use the absolute values.

Acquisition vs. Disposition:

- **Acquisition:** Grace period such that due no later than 71 calendar days after the initial Form 8-K filed to report the acquisition.
- **Disposition:** Due with Form 8-K to report disposition; no grace period. Assuming no proxy statement solicitation, pro forma balance sheet and income statements required if any significance test exceeds 10%. May separately trigger ASC 205-20 discontinued operations reclassification of prior periods and reissuance of audited financial statements.

If Any Significance Test Level Is:	Audited	Unaudited	Pro Formas (Article II)
20% or less	None		
Over 20% to 40%	Target's most recent fiscal year.	Latest required interim period that precedes the acquisition and corresponding interim period of the preceding year	Condensed balance sheet for Buyer's most recent period; and Income statements for Buyer's most recent fiscal year and interim stub period.
Over 40% to 50%	Target's two most recent fiscal years.		
Over 50%* *for offerings, includes "probable" acquisitions as well	Target annual revenue \$50m or more: three most recent fiscal years. Target annual revenue under \$50m: two most recent fiscal years. (FRM 2030.1)		

SEC Manual: www.sec.gov/divisions/corpfin/cffinancialreportingmanual.pdf

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