

UNIVERSITY OF PENNSYLVANIA

Deals: The Economic Structure of Transactions and Contracts

LAW 720/MGMT 717

Spring 2015

Mondays and Wednesdays 3:00 to 4:20 PM Law School room TBA

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This course will focus on the creation of value through transaction and contract design. The goals of the course are to explain how private parties structure and negotiate their commercial interactions, to discuss theories of how they ought to do so and to give students a thorough understanding of the deal process.

The first two months will be devoted to discussion of barriers to transacting -- including information problems and strategic behavior -- and a range of techniques to respond to them as well to other practical aspects of the deal process. In this first part, student teams will also be assigned to follow a one of a group of currently pending transactions. In the final six weeks of the course, (different) student teams will apply the tools developed in Part I to a series of recent and particularly interesting completed transactions. This syllabus covers the first of these two parts in detail. The second part will be described once the semester is underway.

Required reading: James C. Freund, *Anatomy of a Merger: Strategies and Techniques for Negotiating Corporate Acquisitions*, course materials on Canvas and in the syllabus and handouts.

Grading bases: Class participation (50%--25% Part I, 25% Part II), assigned problems (10%), two short papers or one longer one (20%), and two group presentations (10% each).

Class 0 (January 12)
Background

- 1) Schools Brief - Unlocking Corporate Finance, The Economist 81-82 (December 8, 1990).
- 2) Stephen Ross, Randolph Westerfield & Jeffrey Jaffe, Corporate Finance 417ff (7th ed. 2005).
- 3) 4Q 2014 M&A Review (Link to follow once the numbers exist—for 2013 version, see http://share.thomsonreuters.com/pr_us/Prelim_MA_Financial4Q13_Review.pdf .}
- 4) Top 10 Most Important 2014 IPOs (Link to follow once the list exists—for 2013 version, see <http://business.time.com/2013/12/04/business/slide/top-10-most-important-ipos/>.)
- 5) The Prize in Economics 1985 - Press Release – http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1985/press.html
- 6) The Prize in Economics 1990 - Press Release – http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1990/press.html
- 7) Franco Modigliani and Merton H. Miller, “The Cost of Capital, Corporation Finance and the Theory of Investment,” 48 American Economic Review 261ff (1958). (You may skim the equations and proofs—there are more elegant ways to establish the results and it is the basic ideas that are of interest to us here.)

Class 1 (January 14)
Introduction

- 1) Josh Levin, Bullpen Market, (A minor-league pitcher named Randy Newsom is selling shares of his future earnings. Should you invest? If you could have a meeting with him to argue for changes in the terms, what alternative terms might you want to suggest?) Additional materials in Canvas announcement.
- 2) Fantex SEC Prospectus of October 31, 2013 (<http://www.sec.gov/Archives/edgar/data/1573683/000104746913010117/a2217205zsl1a.htm>)
- 3) Note on Implied Warranties
- 4) Potato Chip Supply Agreement (If you represented a major national snack food company and wanted Supplier to be a major vendor to you of potato chips, how might you mark up—for the other side’s consideration—this draft agreement?)
- 5) Briefing memo on Part I deals, team assignments, and group presentation dates (Part I deals currently imagined to be Valeant/Allergen hostile acquisition, P&G Duracell spinoff, HP splitup, Comcast/TWC/GreatLand Connections acquisition/sponsored spinoff, GE Appliances/Electrolux acquisition, and GE Power/Alstom acquisition.)

[NO CLASS ON JANUARY 19 -- Martin Luther King Day]

Class 2 (January 21)
The Reverse Modigliani-Miller Theorem and Introduction to Mergers and Acquisitions

- 1) Pfizer-Wyeth Merger Agreement, January 25, 2009 (handiwork of Casey Cogut L ’73): Skim Article I

- 2) Peter Huang and Michael Knoll, Corporate Finance, Corporate Law, and Finance Theory, 74 Southern California Law Review 175 (2000), pages 177-80.
- 3) Michael Knoll and Daniel Raff, “A Comprehensive Theory of Deal Structure: Understanding How Transactional Structure Creates Value” 89 Texas Law Review See Also 35ff.
- 4) Robert Bruner, Applied Mergers and Acquisitions, pages 531-38.
- 5) William J. Carney, Essentials of Mergers and Acquisitions, pages 13-25
- 6) James Freund, Anatomy of a Merger (1975) ages 1-51. (Specific passages will be assigned for various classes but—despite its date of publication—anyone planning on going into transactional work will find the book worth reading in its entirety over the course of the semester.)

Class 3 (January 26)
Informational Asymmetry: Adverse Selection I

- 1) Real Estate Deal with Free Look Clause
- 2) George Akerlof, The Market for Lemons: Quality, Uncertainty and the Market Mechanism, 84 Quarterly Journal of Economics 488-500 (1970) (read, but do not struggle over, the technical details of the model).

Class 4 (January 28)
Informational Asymmetry: Adverse Selection II

- 1) Pfizer-Wyeth Merger Agreement, Article III.
- 2) Ronald Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 Yale Law Journal 239ff, pages 269 – 280 (1984) (Value Creation).
- 3) James Freund, Anatomy of a Merger, pages 139-174, 242-248 (1975).
- 4) Grumman v. Rohr 748 F.2d 729 (2d Cir. 1984)

Class 5 (February 2)
Agency Costs: Moral Hazard I

- 1) Pfizer-Wyeth Merger, Articles V, VII, and VIII (sections on covenants, closing conditions, termination).
- 2) Problem: Illinois Lottery Sale
- 3) Tom Baker, On the Genealogy of Moral Hazard, 75 Texas Law Review 237-292 (1996)
- 4) James Freund, Anatomy of a Merger, 285-324 (1975)

Class 6 (February 4)
Agency Costs: Moral Hazard II

- 1) Ronald Gilson, Value Creation, pages 280 - 293.
- 2) Ronald Gilson and Reiner Kraakman, Mechanisms of Market Efficiency, 70 Virginia Law Review 549, pages 613 – 621 (1984).
- 3) Possible problem assignment: A note on Hotel Management and Ownership.
- 4) Possible problem assignment: San Francisco Luxury Hotel Development

Class 7 (February 9)
Asset Specificity I

- 1) Possible problem assignment: Levi's-Designs Joint Venture Part I.
- 2) Possible problem assignment: Pay or Play, Take or Pay.

Class 8 (February 11)
Asset Specificity II

- 1) Possible problem assignment: Levi's-Designs Joint Venture Part II: Rights of First Refusal.
- 2) Possible problem assignment: Miami Dolphins Case Study: Right of First Refusal

Class 9 (February 16)
Taxation: Basic Principles (Also start Part I team presentations)
NB that class Meets despite President's Day

- 1) Myron Scholes et al., Taxes and Business Strategy, pages 1-8, 118-27, 130-32.
- 2) Guy Baehr, NJ Transit Getting Foreign Firms to Pay the Fare: Overseas lease-back tax shelters proving profitable for agency, The Newark Star Ledger, July 25, 1995.
- 3) Andrew McIntosh, Governor in the Jet-Lease Business, Sacramento Bee, January 3, 2006.
- 4) Bob Turner et al., Transfer Pricing Gets More Scrutiny, Financial Executive, May 1, 2004. "Explanation of Calculations in PAI Leasing Example."

Class 10 (February 18)
Taxation: Mergers and Acquisitions

- 1) Problem: Pinnacle's acquisition of Tangent.

Class 11 (February 23)
Taxation: Other Regulations

- 1) John Carryrou and Maurice Tamman, A Device to Kill Cancer, Lift Revenue, Wall Street Journal, December 10, 2010.
- 2) 42 U.S.C. § 1320 – 7b(b).
- 3) 42 U.S.C. § 1395nn (excerpts)

Class 12 (February 25)
Exogenous Risk

- 1) James Freund, Anatomy of a Merger, 363-388 (1975)
- 2) Indemnification exercise
- 3) Possible further materials

Class 13 (March 2)
Putting It All Together: Contingent Contracts

- 1) Robert Bruner, *Applied Mergers and Acquisitions*, pages 609-22.
- 2) Problem: Contingent Compensation Problem: Sports Apparel Licensing (Be prepared to answer the questions in class).
- 3) Problem: Sale of a Regional Brewer.

Class 14 (March 4)
Putting It All Together: Capital Structure

- 1) Marriott Spinoff Case Study (A) (For this case, please be prepared to answer the following questions in class: (a) If you were on the board of Marriott would you have approved this transaction? (b) why or why not?).
- 2) Problem: Goodyear Tire & Rubber.

CLASS WILL NOT MEET ON MARCH 9 OR MARCH 11 DUE TO SPRING RECESS

Classes 15 and 16 (March 16 and 18)

Materials to be distributed

Classes 17-26 (March 23 through April 22)
The Deals

Materials to be distributed

[Transactions currently being contemplated: Dell going private, Comcast/NBCUniversal acquisition, combination of Engility/TASC (two defense services providers—see WSJ Oct. 28 2014)]