

UNIVERSITY OF PENNSYLVANIA

Deals:

The Economic Structure of Transactions and Contracts

LAW 720/MGMT 717

Spring 2019

Mondays and Wednesdays 3:00 to 4
Silverman 245A
University of Pennsylvania Law School

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This course is about 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-making process.

The basic idea in the background is that the structuring of transactions and the execution of contracts is informed by a limited number of core economic ideas. The lawyer or banker executing a contract or structuring a transaction can be analogized to a structural engineer, someone whose job it is to choose from a range of possible transactional structures or contractual terms one that is well-suited to the particulars of the situation participants, that addresses potential stresses, and that overall seems likely to maximize the total distributable value. Although transactional structures and contractual provisions appear to have almost unlimited possible variation, a small number of core economic issues cause most of the problems and in practice a limited number of basic approaches to addressing them are deployed, and sometimes balanced, in deciding what to do. Accordingly, the aims of this course are to familiarize students with the basic economic issues that impact transactional structures, to teach students how to recognize these issues when they arise, to familiarize students with the generic solutions to these problems, and to learn how to match existing solutions and problems. In

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addition, students will learn how to fine tune these generic solutions to specific problems, and more broadly develop the skills to devise appropriate solutions to apparently new problems.

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 the final five weeks of the course, 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 background reading: Course materials on Canvas and in the syllabus plus occasional in-class handouts. For optional background reading on mergers and acquisitions for those interested, Christopher S. Harrison, *Make the Deal: Negotiating Mergers and Acquisitions* (New York: Wiley, 2016) can be had from Amazon or the publisher.

Grading bases: Individual transactional analysis paper (30%), Team's Part II deal-related responsibilities (class presentation and secondary roles) (30%), Individual Part II deal paper (20%), Individual class participation (10%), Problem sets and exercises (10%).

Course mechanics are described in a separate memo.

REGULAR ATTENDANCE IS EXPECTED. YOU MAY WORK ALONE OR IN PAIRS ON ALL HOMEWORK PROBLEMS. HOWEVER, THE INDIVIDUAL PAPERS MUST BE INDIVIDUALLY WRITTEN.

Syllabus:

Class 0 (January 14)
LAW STUDENTS ONLY—WHARTON TERM NOT YET COMMENCED
Some Economics Background

The readings below for Class 0 are strictly optional, but deeply thought provoking:

Royal Swedish Academy of Sciences, Press Release 15 October 1985 (Announcement of the Nobel Prize in Economics for 1985)

Royal Swedish Academy of Sciences, Press Release 16 October 1990 (Announcement of the Nobel Prize in Economics for 1990)

(If you are curious, Franco Modigliani and Merton H. Miller, *The Cost of Capital, Corporation Finance, and the Theory of Investment*, *American Economic Review* 48(3) (June, 1958): 261-297)

Ronald H. Coase, *The Nature of the Firm*, 4 *Economica* 386 (1937).

Class 1 (January 16)
ALL STUDENTS HEREAFTER
Introduction

Josh Levin, Bullpen Market, (A minor-league pitcher named Randy Newsom is selling shares of his future earnings. Should you invest?)

A Note on Implied Warranties

Potato Chip Supply Agreement (How might you modify this agreement if you represented a major national snack food company and wanted supplier to be a major supplier to you of potato chips?)

NB: NO CLASS (NO CLASSES) ON MONDAY, JANUARY 21 DUE TO MARTIN LUTHER KING HOLIDAY

Class 2 (January 23)
The Reverse Modigliani-Miller Theorem and an introduction to mergers and acquisitions

IBM-Red Hat Merger Agreement October 28, 2018 (skim Article I)

Peter Huang and Michael Knoll, Corporate Finance, Corporate Law, and Finance Theory, 74 Southern California Law Review 175 (2000), pages 177-80.

Robert Bruner, Applied Mergers and Acquisitions, pages 531-38.

William J. Carney, Essentials of Mergers and Acquisitions, pages 13-25

Class 3 (January 28)
Informational Asymmetry: Adverse Selection I

James Freund, Anatomy of a Merger, pages 1-51 (1975).

Problem to be handed in before class: Real Estate Deal with Free Look Clause

Class 4 (January 30)
Informational Asymmetry: Adverse Selection II

IBM-Red Hat Merger Agreement, Article III (Representations and Warranties)

Ronald Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 Yale Law Journal 239, pages 269 – 280 (1984) (Value Creation).

James Freund, Anatomy of a Merger, pages 242-248 (1975).

Grumman v. Rohr 748 F.2d. 729

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Class 5 (February 4)
Agency Costs: Moral Hazard I

IBM-Red Hat Merger Agreement, Articles IV, VI, and VII (sections on covenants, closing conditions, termination).

Tom Baker, “On the Genealogy of Moral Hazard,” 75 Texas Law Review 237-292

Illinois Lottery Sale

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

Ronald Gilson, Value Creation, pages 280 - 293.

Ronald Gilson and Reiner Kraakman, Mechanisms of Market Efficiency, 70 Virginia Law Review 549, pages 613 – 621 (1984).

A note on Hotel Management and Ownership.

Problem to be handed in before class: San Francisco Luxury Hotel Development.

Class 7 (February 11)
Asset Specificity I

Apple-SCI turnkey agreement

Fountain Manufacturing Agreement

Indicative Summary of Terms for GM Temporary Loan Facility

Problem to be handed in before class: Pay or Play, Take or Pay.

Class 8 (February 13)
Asset Specificity II

Levi’s-Designs Joint Venture Part I: Put-Call Provision (Be prepared to answer questions at end of the case – do not hand in).

Levi’s-Designs Joint Venture Part II: Rights of First Refusal (Be prepared to answer questions at end of the case – do not hand in).

Problem to be handed in before class: Miami Dolphins Case Study: Right of First Refusal

(Again, you may work alone or in pairs).

Class 9 (February 18)

Taxation: Some Basic Principles

Myron Scholes et al., Taxes and Business Strategy, pages 1-8, 118-27, 130-32.

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.

Andrew McIntosh, Governor in the Jet-Lease Business, Sacramento Bee, January 3, 2006.

Bob Turner et al., Transfer Pricing Gets More Scrutiny, Financial Executive, May 1, 2004.

"Explanation of Calculations in PAI Leasing Example."

Myron Scholes, Introduction to Tax Strategy, 1-8 and 118-132

Andrew MacIntosh, Tax Shelters for the Rich Only, Sacramento Bee, January 3, 2006

Class 10 (February 20)

Taxation: Corporate Combining

Joint Venture Tax Structuring in M&A Transactions

Guest lecturers: Lewis Steinberg and Adam Perry, Bank of America

Excerpts from Molson Coors 8-K, MillerCoors Joint Venture Agreement (tax treatment), Red Rock Resorts S-1 (structure description), Graphic Packaging 8-K, Graphic Packaging-International Paper Transaction Agreement (tax treatment), Coty Press Release, Black Knight Financial Services 8-K, Black Knight HoldCo S-4 (visual representation of the transaction) (pdf)

Class 11 (February 25)

Taxation: Corporate Dispositions

Spin-offs, Split-offs, and Carve-outs I:

The GE-Westinghouse Air Brake Technologies Corporation Transaction

Guest lecturer: Rick d'Avino, PWC

GE-Westinghouse Air Brake Technologies Corporation Amendment No. 3 to S-4 filed 1/25/2019, pp. 1-22, 34-35, 46-55, 84-89, and 184

Press release: "Wabtec and GE Modify Terms of Transaction, Expect to Close By End of February 2019," Westinghouse Air Brake Technologies Corporation 1/25/2019

"General Electric: Thoughts on the 'Reworked' Wabtec deal," Seeking Alpha 1/28/2019

"GE -4% as analyst rips revised Wabtec merger terms", Seeking Alpha 1/28/2019

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Class 12 (February 27)
Taxation: Corporate Dispositions II
Spin-outs, Split-offs, and Carve-outs II:
GE Healthcare Transaction
Guest lecturer: Rick d’Avino, PWC

“General Electric’s Healthcare IPO is actually just what the doctor ordered,” Seeking Alpha
12/29/2018
(Further readings to come)

CLASS WILL NOT MEET ON MARCH 4 OR MARCH 6 DUE TO THE UNIVERSITY
SPRING VACATION.

Class 13 (March 11)
Taxation: Corporate Dispositions spillover and perhaps further topics
Guest lecturer: Rick d’Avino, PWC and General Atlantic Partners

(Readings to be announced)

Class 14 (March 13)
Exogenous Risk

(Readings to be announced)

Class 15 (March 18)
Putting It All Together: Contingent Contracts

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

Class 16 (March 20)
Putting It All Together: Capital Structure
and
An Introduction to Part II

Marriott Spinoff (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?).
Problem to be handed in before class: Goodyear Tire & Rubber.

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Classes 17-24 (March 25 through April 24)
The Deals

Materials to be distributed