

UNIVERSITY OF PENNSYLVANIA

Deals:

The Economic Structure of Transactions and Contracts

LAW 720/MGMT 717

Spring 2022

Mondays and Wednesdays 3:30 to 5:00
JMHH (“Huntsman”) F-55
University of Pennsylvania

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This course is about the creation of value through transaction and contract design. It is to some extent also about value capture. 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 both the structuring of transactions and the execution of contracts are informed by a limited number of core economic ideas. The lawyer or banker or other financial services industry professional 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, that addresses potential stresses or challenges, 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 the course of 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 addition, students will learn how to fine tune these generic solutions to specific problems, and more broadly to develop the skills necessary 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 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. (The publisher would, of course, appreciate it if you would buy it directly.)

Grading bases: Class participation (20%); Team’s Part II deal-related responsibilities (team’s class presentation, execution of secondary team role, final version of paper) (40%); Take-home final exam (40%).

Course mechanics and team roles are described in a separate memo.

Please read everything on this syllabus. The cases, newspaper articles, and other materials that are the basis for extended in-class discussion are in **bold**. Please read these materials particularly carefully beforehand and come to class ready to discuss them in depth.

Regular attendance and active class participation is expected.

Note well: The course is designed to be self-contained for both Law and Wharton students. Term for the Law School starts a week before term for Wharton. Classes 0 and 00 on the syllabus below will take place in that week and are therefore intended for Law students only. (Wharton students are of course welcome to peruse the material if they like and Professor Raff would be happy to discuss questions arising with any Wharton students who would like to talk any of the readings through.) Class 000, which is also for Law students only, will take place on March 2, also not a Wharton teaching day.

Syllabus:

Class 0 (January 10)

An introduction to some background ideas for the course I

NB: LAW STUDENTS ONLY

Michael S. Knoll and Daniel M.G. Raff, Real Sports Investments and the First Major League Baseball Self-IPO. (*A minor-league pitcher named Randy Newsom is selling shares of his future earnings. Should you invest?*).

Class 00 (January 12)

An introduction to some background ideas for the course II

NB: LAW STUDENTS ONLY

School's Brief: Unlocking Corporate Finance, *The Economist* 81-82 (December 8, 1990).
Michael S. Knoll, The Modigliani-Miller Theorem at 60 The Long-Overlooked Legal Applications of Finance's Foundational Theorem, 36 *Yale Journal on Regulation Bulletin* 1-7, 12-17 (2018).

(For the very curious, see also 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.)

Steve Lohr & Michael J. de la Merced, GE Breaks Up with Its Storied Past, NY Times, Nov. 10, 2021.

NB: NO CLASS FOR ANYONE ON JANUARY 17 (MLK DAY)

Class 1 (January 19)

Introduction to the Course and Value Creation through Transaction Design

Michael Klausner, Analysis Research and Reports On the Web (ARROW) exercise. (*A startup firm is running out of money. There are two offers on the table. Which should the founder/controlling shareholder accept?*)

[NB: More detailed study questions appear at the end of each exercise. Hereafter, just look for study questions at the end of each exercise.]

Class 2 (January 24)

Value Creation through Organization Design

Adolph Berle and Gardiner Means, The Modern Corporation and Private Property (1932) 119-125.

William A. Sahlman, The Structure and Governance of Venture-Capital Organizations, 27 Journal of Financial Economics 473, 489-493, 503-506 (1990).

Ronald J. Gilson and Daniel M.G. Raff, Visa exercise.

Class 3 (January 26)
Introduction to Mergers and Acquisitions

IBM Closes Landmark Acquisition of Red Hat for \$34 Billion; Defines Open, Hybrid Cloud Future, July 9, 2019.

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

Robert Bruner, Applied Mergers and Acquisitions 531-38.

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

Class 4 (January 31)
Informational Asymmetry: Adverse Selection I

Michael Klausner, Real Estate Deal with Free Look Clause exercise.

Michael Klausner, Genre Productions: Pre-arranged Distribution Agreement exercise.

Class 5 (February 2)
Informational Asymmetry: Adverse Selection II

Ronald J. Gilson, Value Creation by Business Lawyers: Legal Skills and Asset Pricing, 94 Yale Law Journal 239-280 (1984). (Hereafter “Value Creation”).

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

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

Grumman v. Rohr 748 F.2d. 729.

Class 6 (February 7)
Agency Costs: Moral Hazard I

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

Ward Farnsworth and Eric Posner, Agency, in Ward Farnsworth, The Legal Analyst: A Toolkit for Thinking About the Law 87-93 (2007).

Michael S. Knoll and Daniel M.G. Raff Proposed Sale of the Illinois Lottery exercise.

Michael Klausner, Genre Productions: Movie Financing exercise.

Class 7 (February 9)
Agency Costs: Moral Hazard II

Ronald J. Gilson Value Creation 280-293.

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

A note on Hotel Management and Ownership.

Waleed Y.W. Haj Hasan, Rocky: A Case Study of the Adrian Hotel exercise

Class 8 (February 14)

An Introduction to Contracting Techniques for Dealing with Risk and Uncertainty

Frank H. Knight, Risk, Uncertainty, and Profit, pages 233-234

Ronald J. Gilson, Microvision Corporation Acquisition of Installit, Inc.: Negotiating an Earnout exercise [A] case

Ronald J. Gilson, Charles F. Sabel, and Robert E. Scott, “Innovation and Contract: Adaptability and Collaboration in an Uncertain World Draft” chapter 1.

Class 9 (February 16)

MACs, Earnouts, and Information

Robert J. Gilson and Alan Schwartz, Understanding MACs: Moral Hazard in Acquisitions 2-11, 16-19, 26-29.

Ronald J. Gilson and Daniel M.G. Raff, Duraflame exercise.

Mark Maremont, Buffet Makes \$4.5 Billion Deal with Pritzkers, Wall Street Journal December 26, 2007.

Ronald J. Gilson and Daniel M.G. Raff, Roy Vagelos and Oskar Grunwald exercise.

Class 10 (February 21)

Asset Specificity I

Fountain Manufacturing Agreement between Apple Computer Inc., and SCI Systems, Inc. Indicative Summary of Terms for Secured Loan Facility [to the General Motors Corporation], December 19, 2008.

Michael S. Knoll, Wayne Huizenga’s Acquisition of the Miami Dolphins and Joe Robie Stadium exercise

Class 11 (February 23)

Asset Specificity II

Ronald J. Gilson, Victor P. Goldberg, and Robert H. Mnookin, Proton Corporation negotiation exercise (NB: Teams will be assigned and materials circulated on February 22nd. The exercise should be completed between Class 10 and when we assemble for Class 11.)

Class 12 (February 28)
Tax I: Taxation of Corporate Acquisitions and Dispositions

Michael S. Knoll, HCA's Acquisition Tax Strategy exercise

Videos to be viewed before class; they can be watched at between 1.5x and 2x.
Taxation: Basic Principles (40 minutes)
M&A Taxation Part 1 (39 minutes)
M&A Taxation Part 2 (21 minutes)

Class 000 (March 2)
TBD
NB: LAW STUDENTS ONLY

Topic and readings to be assigned

NB: NO CLASS ON MARCH 7 or 9 (UNIVERSITY SPRING VACATION)

Class 13 (March 14)
Tax II: Special Topics in Taxation
Guest speakers: Lewis Steinberg and Adam Perry, Bank of American

Materials to be distributed

Class 14 (March 16)
Loose Ends, Reprise of Part I and a glimpse forward towards the exam,
and an Introduction to Part II

Material to be distributed

Classes 15-24 (March 21 through April 20)
The Deals

List of transactions and materials to be distributed