

MERGERS & ACQUISITIONS 3: STRUCTURING PAYMENT: DEAL POINTS

November 2024

I. Executive Summary

This is the third of our series of expanded and updated advisories on Mergers & Acquisitions (M&A). Like the first two in the series, “Mergers & Acquisitions 1: Overview and Transaction Types” ([M&A 1](#)) and “Mergers & Acquisitions 2: Tax Structuring Considerations” ([M&A 2](#)), it is meant to offer to business executives and their professional advisers an M&A guide both accessible and of practical use when embarking on an M&A transaction in their own business. This advisory will discuss how to structure and pay the Acquisition Consideration or Merger Consideration – the purchase price for the business being acquired in an M&A transaction, with cash, stock, assumption of debt, a combination, or some other form of payment. All advisories in the series will be available on our website at [Kurtin PLLC Mergers & Acquisitions](#).

Following the discussion in each advisory in the series are “Deal Points” on considerations in the purchase or sale of a business that we often raise when we handle these types of transactions for our clients: what to do, and *what at all costs not to do*. Future editions in the series will drill down on issues like preliminary documentation like letters of intent (LOIs), memoranda of understanding (MOUs) and Term Sheets; principal transaction documents like Stock Purchase Agreements, Asset Purchase Agreements and Merger Agreements; securities law considerations, especially when public reporting companies under the Securities Exchange Act of 1934 (the “Exchange Act”) are parties to the M&A transaction and there is a substantial federal securities law regulatory compliance overlay to the transaction (Public M&A); antitrust (competition) law issues; financing the M&A transaction; foreign investment review and technology export rules; employment and equity-based compensation; Cross-border M&A (where Acquirer and Target are domiciled in different countries); due diligence; corporate governance; and industry-specific regulatory regimes. A progressively cumulative glossary of defined technical terms used will appear at the end of each advisory in the series.

II. Acquisition Consideration

Acquisition Consideration (or Merger Consideration), the purchase price paid by Acquirer to Target or its shareholders, is usually paid in cash, stock, the assumption of Target debt or a combination thereof. When Acquirer stock is all or part of the Acquisition Consideration, Acquirer may use existing authorized but unissued stock as Acquisition Consideration or authorize and issue new stock. Acquirer may also finance all or part of the Acquisition Consideration through issuance of stock and/or incurrence of debt for cash. An M&A transaction including assumption of debt as all or part of the Acquisition Consideration may also feature restructuring of the pre-existing debt, with reduction of principal, change of interest rate, extension of maturity date or other creditor accommodations based on their belief that they are more likely to be paid if the deal goes through. Under some circumstances, creditors might agree to restructure debt into equity or convertible debt convertible into preferred stock with liquidation and other preferences to common stock.

- a. Cash Acquisition Consideration. As described in [M&A 2](#), if Acquirer's Acquisition Consideration is paid in cash, the transaction will not be eligible for "tax-free" treatment under Tax Code section 368(a)(1)(A) - (D). However, the tax effects of a cash transaction may be ameliorated by use of the Tax Code section 338(g) and 338(h)(10) elections also described in [M&A 2](#). Cash consideration may be payable in full at closing or in installments and subject to various post-closing contingencies. But cash on the barrelhead, paid in full at closing, is the most valuable and risk-free consideration from Target and Target's shareholders' point of view. A cash-in-full offer should command a significant discount from other types of Acquisition Consideration, including competing offers that are not cash. Any non-cash-in-full offer should be considered as in some measure contingent and command a risk premium for Target and its shareholders. Put simply, any Acquirer willing to pay cash in full at closing should be able to pay less than other potential Acquirers offering non-cash deals in most circumstances, the main exceptions being when Target/Target shareholders expect a significant appreciation in Acquirer's share value as a result of the transaction or over time, want to participate in the post-transaction business for that or other reasons, or when tax-free structuring more than compensates for the assessed risk premium in taking stock instead of cash.
- b. Stock Acquisition Consideration. Target and its shareholders, all other things being equal, usually favor being paid in cash than in stock; after all, if paid in cash, they can always buy Acquirer stock with some of the cash later if they want (assuming it was available at the same price as it was in the

transaction, which may not be the case, especially if the M&A transaction adds value to the post-acquisition business as intended), and stock Acquisition Consideration should ordinarily be subject to a risk premium and a higher purchase price than a cash deal would require, with the exceptions noted above. Conversely, Acquirer's use of stock as Acquisition Consideration can result in tax-free treatment for the transaction when the deal is structured properly, as described in [M&A 2](#), which may compensate for some or all of the risk premium, and of course the parties may be buying into a business case in which the combined companies will be worth more post-closing than the sum of their parts. In fact, if they *don't* believe that, it may be that they shouldn't be doing the deal.

- c. Hybrid Cash and Stock Consideration. The risk premium to Target and its shareholders in accepting Acquirer stock as Acquisition Consideration can be partially mitigated by structuring a deal in which part of the Acquisition Consideration is Acquirer stock, and part is cash. In a "cash election" Merger or other M&A transaction, Target shareholders are granted an election period in which to decide to accept stock or cash for the cash part of the Acquisition Consideration, allowing them to assess market reaction to the announced transaction and its effect on Acquirer's share value. The length of the election period is often heavily negotiated, as is whether to treat all Target shareholders the same way in terms of cash election rights.
- d. Assumption of Debt. Assumption of Target's debt is a key and frequent part of M&A Acquisition Consideration, and often should command a premium, especially when the debt is restructured in the course of the M&A deal – the interest rate lowered, maturity date extended, the terms or collateral requirements eased. Assumption of debt *may* also be tax deductible for the Acquirer, although, since the 2017 Tax Cuts and Jobs Act ("TCJA") lowered the maximum corporate tax rate from 35% to 21%, granted a 20% deduction on qualified business income and capped business interest (whether paid or accrued) deductibility, previously unlimited with a few minor exceptions, at 30% of EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization), and 30% of EBIT thereafter, deductibility of interest is less of a transaction-structuring driver than it used to be.¹

As an aside, limitations on business interest deductibility should disfavor debt financing as a general matter, especially in a time of rising interest rates. Among other things, convertible debt

¹ It should be noted that not only are some of the TCJA business tax reductions sunseting, but the U.S. presidential and legislative elections in November 2024 may impact taxation marginal rates and tax incentives in M&A structuring. We will keep our clients advised of these developments.

instruments, term loans, revolving credit facilities, debentures and short-term notes should all change in relation to each other and to equity as a result of the loss of the full deduction, with the incurring of debt by a business a more expensive proposition than before. The relative availability of debt finance may also be affected.

However, it is important for Acquirer to remember when considering assumption of Target debt that the M&A transaction thereby becomes a marriage with three or more parties: the Target's creditor or creditors are also in the deal. Creditors' consent to the assumption of debt and transfer of obligation from Target to Acquirer, as well as what they might demand in exchange for that consent, as a contingency and a risk must be sought and programmed into the transaction, from the point of LOI, MOU or Term Sheet; deals have cratered on failure to obtain creditor consent to assumption of Target debt, as when, for example, the debt instrument makes a "change of control" without creditor consent an "event of default," creditor does not consent and declares an event of default by reason of the M&A transaction. Not only that, but the LOI, MOU, Term Sheet, Stock Purchase Agreement, Asset Purchase Agreement or Merger Agreement, as the case may be, may make failure to obtain creditor consent a Target covenant and/or Acquirer condition to closing, allowing Acquirer to terminate the transaction and walk away from the deal without penalty.

III. Acquisition Consideration Control Devices

Among the issues confronting M&A parties as they plan, structure and document their transaction are the effects of changes in the value of Target and/or Acquirer's stock when stock is being used as Acquisition Consideration. Various techniques to control or limit those changes in value can be used.

a. Fixed Exchange and Fixed Value Ratio Formulas

Where all or some of the Acquisition Consideration is in stock, parties can also allocate risk of pre-closing volatility through adjustable pricing formulas. In a "Fixed Exchange" ratio, each of Target's shares is converted into a fixed number of Acquirer's shares based on a negotiated and fixed exchange ratio. Under a Fixed Exchange structure, the dollar value of the fixed number of Acquirer shares received by Target/Target shareholders can rise or fall in the period between when the deal is signed and when it closes, thereby changing the value of the Acquisition Consideration, either as a result of Acquirer's business performance, market reaction to the pending deal, or general market/industry conditions incidentally affecting Acquirer. Fixed

Exchange ratios are most common in larger, stock-for-stock “merger of equals” transactions, since both parties share the risk of movement in Acquirer’s share price. Fixed Exchange transactions are also traditionally common in sectors of perceived volatility, such as the tech sector, and Acquirer’s resulting position that volatility risk in its stock price should be shared.

In a “Fixed Value” transaction, it is the exchange ratio that floats and Target/Target shareholders receive a fixed dollar value of Acquisition Consideration, however many Acquirer shares that works out to cost. The formula usually provides for measuring Acquirer’s stock price during a negotiated period of days or weeks prior to closing or a meeting of Target’s stockholders to approve the transaction. A Fixed Value pricing formula is used to insulate Target’s shareholders from risk from changes in Acquirer’s share value prior to closing, whether from the Acquirer’s business performance, market reaction to the pending deal, or general market/industry conditions incidentally affecting Acquirer. Fixed Value transactions are traditionally most common when one party is clearly Acquirer and the other clearly Target, rather than in the “merger of equals” context and, unlike in Fixed Exchange ratio transactions, pose the risk for Acquirer that it may have to issue more shares to purchase Target’s shares or assets if Acquirer’s share value declines during the measuring period, which may reduce the stock value and dilute existing Acquirer shareholders (of course, a rise in Acquirer’s stock value prior to closing will allow it to close the transaction on fewer shares). Also, in Public M&A, hostile bidders use Fixed Value structures because they have more appeal for Target shareholders, who may be solicited under a tender offer and are more likely to tender based on a known dollar compensation for their shares.

Fixed Exchange and Fixed Value pricing formulas can be used with hybrid cash and stock transactions, in which the cash component can vary in inverse relation with the variations in the stock component, potentially altering both the overall Acquisition Consideration and the risk premium-modifying aspects of the cash component already discussed, factors which will be heavily negotiated and on which Target shareholders may have divergent interests.

- b. “Collars,” “Caps” and “Floors” are used to limit the volatility of transactions in which Acquirer stock is all or part of the Acquisition Consideration and can be used in both Fixed Exchange and Fixed Value transaction structures to limit the volatility of the dollar value of the Acquisition Consideration in a Fixed Exchange structure, or the amount of Acquirer stock to be paid as Acquisition Consideration in a Fixed Value structure. A Collar would set a maximum (Cap) and

minimum (Floor) limit on the dollar amount that Target/Target shareholders would receive in a Fixed Exchange deal, or the number of Acquirer shares that Target/Target shareholders would receive in a Fixed Value deal, even if market volatility and pre-closing valuation affecting Acquirer's stock price justified a higher or lower amount of one or the other at closing. Essentially, Collars, Caps and Floors function as "circuit breakers" for the otherwise potentially infinite volatility of either type of structure. Above or below the Collar, the volatility protection ends, and for the excess above or below the Collar, the parties bear the risk of greater volatility. A Collar on Acquisition Consideration can also be used to allocate risk in other pre-closing scenarios, such as due diligence, regulatory approvals, third party consents and other events potentially affecting Target value pre-closing. Caps and Floors can also be used individually, and not as part of a Collar.

c. Deferred Consideration and Earn-outs

A transaction may be structured in which Target, in whatever form it exists post-closing, is required to hit certain milestones to receive a portion of the Acquisition Consideration. That portion may be set aside in escrow or simply deferred until the milestone is reached, earning the payout or release from escrow of the segregated purchase price portion.

IV. Deal Points

Deal Point No. 1: Plan Acquisition Consideration and its structure at the LOI, MOU or Term Sheet stage. Nobody, especially on the Target/sell side, wants to hear about a change in purchase price after the deal is signed up and before closing. When the issue is identified and its risk is allocated in preliminary documentation and the main deal documents, the occurrence of an Acquisition Consideration-altering event is accounted for and should not give rise to disputes.

Deal Point No. 2: Think about the effects of Acquisition Consideration structuring in negotiations. Do Target/Target shareholders want to cash out? Or do they want to participate in the post-closing business? Will using Acquirer's stock limit Acquirer's strategic options going forward, or impair

Acquirer's existing shareholders' interests? What is the "cheapest" price to pay, cash, stock or assumed debt? Can an Acquisition Consideration decision solve a particular need of Target/Target shareholders or Acquirer/Acquirer shareholders?

Owen D. Kurtin

About Us

Kurtin PLLC is a New York City-based law firm founded in 2008 and celebrating its 16th anniversary this year. Our practice focuses on corporate, finance, commercial and regulatory representation for both mature and early stage companies, investment funds, investors and lenders in the [Biotechnology & Life Sciences](#), [Communications & Media](#), [Information Technologies & Internet](#), [Satellites & Space](#), and [Venture Capital & Private Equity](#) sectors. Among our key values, none rank higher than creative and individualized solutions to business issues, absolute client discretion and unsurpassed responsiveness. Since our founding, we have represented clients in over 40 countries on six continents and across the United States on transactional and dispute resolution matters.

Please visit our website at <https://kurtinlaw.com> and contact us at info@kurtinlaw.com or +1.212.554.3373 for more information on our professional legal services. To subscribe to our publications mailing list, please email publications@kurtinlaw.com with the message "Subscribe" and your name, company or other professional affiliation and preferred email address.

The materials contained in this advisory have been prepared for general informational purposes only and should not be construed or relied upon as legal advice or a legal opinion on any specific facts and circumstances. The publication and dissemination, including on-line, of these materials and receipt, review, response to or other use of them does not create or constitute an attorney-client relationship.

To ensure compliance with requirements imposed by the Internal Revenue Service, we inform you that any tax advice contained in this communication (including any attachments) was not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any tax-related matter(s) addressed herein.

These materials may contain attorney advertising. Prior results do not guarantee a similar outcome.

Copyright © Kurtin PLLC 2022 - 2024. All Rights Reserved.

T: 212.554.3373 | E: info@kurtinlaw.com | W: <https://kurtinlaw.com>

Mergers & Acquisitions: Deal Points
Cumulative Glossary
Appendix 1

- 1. Acquiror (or Acquirer, Buyer or Purchaser):** the purchaser, or “buy side” party in an M&A transaction, whether an Asset Purchase or a Stock Purchase, which acquires all or the majority of the stock or assets of another business. In a Merger, the parties are not technically purchaser or seller, but when one party is clearly the dominant party in the transaction, and is often the Surviving Entity (though not always, as in the case of a Reverse Merger), that party can be thought of as the Acquiror.
- 2. Acquisition Consideration:** the purchase price paid by Acquiror to Target in an M&A transaction, whether in cash, stock, assumed debt or a combination thereof.
- 3. Asset Purchase:** a transaction by which one party to an M&A transaction purchases all or the majority of the assets of another party. Distinguished from a sale by Target in the ordinary course of business, as in selling a part of its inventory, or surplus equipment not needed for continuing its business operations.
- 4. Asset Purchase Agreement:** a contractual agreement serving as the principal document by which an Asset purchase is effected.
- 5. Cash Election Merger:** an M&A transaction in which Target shareholders are granted an election period to decide whether to accept stock or cash as all or part of the Acquisition Consideration.
- 6. Cross-border M&A:** M&A transactions in which Acquiror is domiciled in one country, and Target in another country. For purposes of this M&A: Deal Points series, one of those countries in which either Acquiror or Target is domiciled is the United States.
- 7. DGCL:** the Delaware General Corporation Law, serving as a paradigm corporation statute in the U.S., and frequently the basis of incorporation by U.S. companies, wherever physically based, that intend to do business across the U.S. as well as inbound subsidiaries of non-U.S. companies wishing to have operations in the U.S.

- 8. Due Diligence:** the scope of the parties' disclosures to each other before the M&A transaction closes, generally buttressed by deal protections in the form of warranties, representations, covenants and linked rights of indemnification, termination, conditions to closing and others.
- 9. EBITDA:** Earnings Before Interest, Taxes, Depreciation and Amortization, a common accounting metric.
- 10. Exchange Act:** the Securities Exchange Act of 1934, as amended, governing resales of already-issued securities, both debt and equity, and the periodic reporting obligations of publicly registered companies.
- 11. Fixed Exchange Ratio:** Where not all the Acquisition Consideration is in cash, parties can also allocate risk of pre-closing volatility through adjustable pricing formulas. In a Fixed Exchange Ratio, each of Target's shares is converted into a fixed number of Acquiror's shares based on a negotiated and fixed exchange ratio. Under a Fixed Exchange structure, the dollar value of the fixed number of Acquiror shares received by Target/Target shareholders can rise or fall in the period after the deal is signed and when it closes, thereby changing the value of the Acquisition Consideration, either as a result of Acquiror's business performance, market reaction to the pending deal, or general market/industry conditions incidentally affecting Acquiror. Fixed Exchange Ratios are most common in larger, stock-for-stock "merger of equals" transactions, since both parties share the risk of movement in Acquiror's share price. Fixed Exchange Ratio transactions are also traditionally common in sectors of perceived volatility, such as the tech sector, and Acquiror's resulting position that volatility risk in its stock price should be shared.
- 12. Fixed Value Ratio:** In a Fixed Value Ratio transaction, the exchange ratio that floats and Target shareholders receive a fixed dollar value of Acquisition Consideration, however many Acquiror shares that works out to cost. The formula usually provides for measuring Acquiror's stock price during a negotiated period of days or weeks prior to closing or a meeting of Target's stockholders to approve the transaction. A Fixed Value pricing formula is used to insulate Target's shareholders from risk from changes in Acquiror's share value prior to closing, whether from the Acquiror's business performance, market reaction to the pending deal, or general market/industry conditions incidentally affecting Acquiror. Fixed Value Ratio transactions are traditionally most common when one party is clearly

Acquiror and the other clearly Target, rather than in the “merger of equals” context and, unlike in Fixed Exchange Ratio transactions, pose the risk for Acquiror that it may have to issue more shares to purchase Target’s shares if Acquiror’s share value declines during the measuring period, which may reduce the stock value and dilute existing Acquiror shareholders (of course, a rise in Acquiror’s stock value prior to closing will allow it to close the transaction on fewer shares). Also, in Public M&A, hostile bidders often use Fixed Value Ratio structures because they have more appeal for Target shareholders, who may be solicited under a tender offer and are more likely to tender based on a known dollar compensation for their shares.

- 13. IRS:** the Internal Revenue Service, the U.S. federal tax regulatory and enforcement agency.
- 14. JV:** Joint Venture. JVs usually imply a formal collaboration short of merger or acquisition between two or more enterprises through a newly formed business entity or contract, as opposed to “Strategic Alliances,” which usually involve two or more parties working to achieve a specific goal of mutual interest while remaining independent.
- 15. LLC:** a limited liability company organized under a state’s LLC statute, generally offering the limited liability protection for shareholders of corporations with the “pass-through” taxation of partnerships (i.e., not taxed at the LLC level, but taxable income or loss is “passed through” to the owners, called “members,” equivalent to a corporation’s shareholders). Also usually featuring less burdensome management and governance costs and formalities than equivalent corporations.
- 16. LP:** a limited partnership under a state’s limited partnership statute (usually modeled on the Uniform Limited Partnership Act), generally offering the limited liability protection for shareholders of corporations with the “pass-through” taxation of partnerships (i.e., not taxed at the LP level, but taxable income or loss is “passed through” to the limited partners, equivalent to a corporation’s shareholders). Also usually featuring less burdensome management and governance costs and formalities than equivalent corporations.
- 17. M&A:** generally used abbreviation for “Mergers & Acquisitions,” a catch-all term sweeping up Stock Purchases, Asset Purchases and Mergers, all involving the legal or *de facto* acquisition of all or a majority of one business’s stock or assets by another business.

18. Merger (or Statutory Merger): a process set forth in the company law statutes of the individual states by which two companies merge with each other, leaving one company or its subsidiary as the Surviving Entity, while the other company merges into that company or its subsidiary and ceases to exist as a separate legal entity.

- a. **Direct Merger:** A Merger structure in which Target merges directly into Acquiror, which is the Surviving Entity, while Target ceases to exist.
- b. **Reverse Merger:** A Merger structure in which Acquiror merges into Target, which is the Surviving Entity, while Acquiror ceases to exist.
- c. **Forward Triangular Merger:** A Merger structure in which Acquiror forms a subsidiary (**Merger Sub**) (or uses a pre-existing subsidiary), Target merges into Merger Sub, Merger Sub is the Surviving Entity and a subsidiary of Acquiror, while Target ceases to exist.
- d. **Reverse Triangular Merger:** A Merger structure in which Merger Sub merges into Target, Target is the Surviving Entity and becomes a subsidiary of Acquiror, while Merger Sub ceases to exist.

All of these Merger structures are diagrammed in [M&A 1](#).

19. Merger Agreement (or Agreement and Plan of Merger): a contractual agreement serving as the principal document by which a Merger is effected.

20. Merger Consideration: the Acquisition Consideration in a Merger.

21. Preliminary Document: (MOU, or Memorandum of Understanding; LOI, or Letter of Intent; or Term Sheet. Also, NDA, or Non-Disclosure Agreement, which may be part of an MOU, LOI or Term Sheet or a standalone Preliminary Document): forms of preliminary documentation used to set a framework for an M&A transaction and confidentiality before executing documents like an Asset Purchase Agreement or Stock Purchase Agreement. Some terms in preliminary documentation may be binding on the parties for a certain period, for example confidentiality or exclusivity, while others are

usually not binding.

- 22. Public M&A:** M&A transactions involving a Target that is a public reporting company under the Exchange Act, requiring a substantial Exchange Act and SEC regulatory overlay of requirements for the transaction.
- 23. SEC:** the Securities and Exchange Commission, the U.S. federal securities regulator.
- 24. Securities Act:** the Securities Act of 1933, as amended, governing initial issuances of securities, both debt and equity.
- 25. Stock Purchase:** a transaction by which one party purchases all or the majority of the stock of another party. Distinguished from a minority investment by one party in the other, such as a typical venture capital investment, which is not an M&A transaction.
- 26. Stock Purchase Agreement:** a contractual agreement serving as the principal document by which a Stock Purchase is effected.
- 27. Surviving Entity:** the company that continues its corporate existence and operations following a merger.
- 28. Target (or Seller):** the seller, or “sell side” party in an M&A transaction, whether an Asset Purchase or a Stock Purchase, which sells all or the majority of its stock or assets to another business, the Acquiror. In a Merger, the parties are not technically purchaser or seller, but when one party is clearly the less dominant party in the transaction, and is often the merged party (though not always, as in the case of a Reverse Merger or Reverse Triangular Merger, that party can be thought of as the Target.
- 29. Tax Code:** the U.S. Internal Revenue Code, 26 U.S.C.
- 30. TCJA:** the Tax Cut and Jobs Act of 2017.