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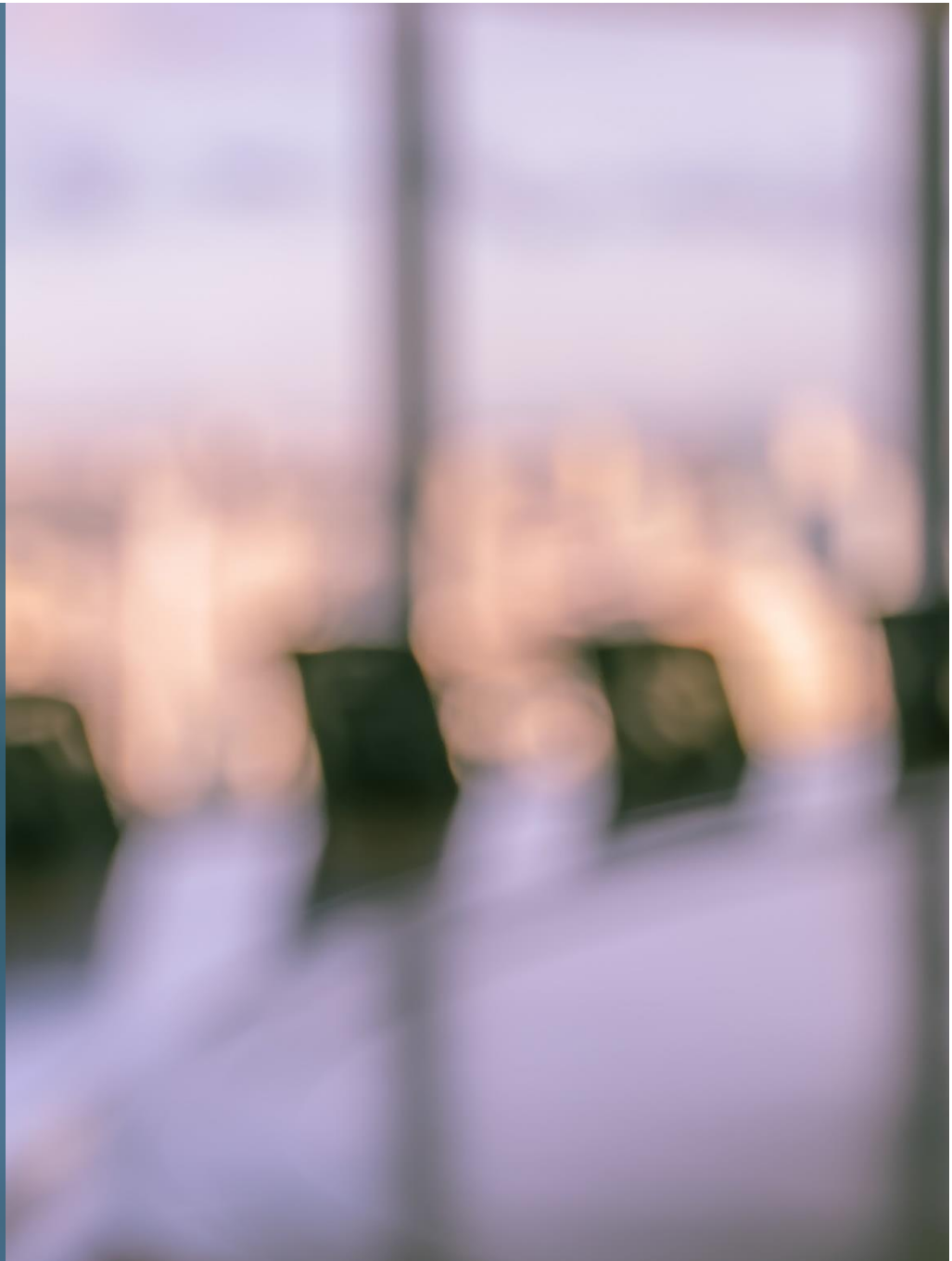
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M&A TRANSACTION STRUCTURES: CORPORATE, REPORTING AND TAX CONSIDERATIONS

Energy Finance Series

velaw.com



TODAY'S PANEL



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ENERGY SERIES

Seminars & Continuing Legal Education Programs

Responding Effectively to Environmental Shareholder Activism

Tuesday, July 11, 2017

Speakers: Kai Liekefett; Margaret Peloso; Leonard Wood

DISCUSSION TOPICS

Factors that Drive Acquisition Structures	05
Deal Structures – Corporate Targets	08
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I. FACTORS THAT DRIVE ACQUISITION STRUCTURES

- Consideration mix
- Shareholder vote issues
- Financing issues
 - Existing target debt and transaction financing
- Restrictions on the ability to merge target out of existence
- Tax attributes of the parties
- Post-closing restructuring plans
- Inversion concerns

I. FACTORS THAT DRIVE ACQUISITION STRUCTURES

CONSIDERATION MIX

- Threshold Question: Will cash be included and, if so, how much?
- Business Judgment Rule v. Enhanced Scrutiny (*Revlon*)
 - Business Judgment Rule – Under this default standard, courts will presume that, in making a business decision, the directors were disinterested and acted on an informed basis, in good faith and in the honest belief that action was taken in the best interests of the corporation
 - Absent a plaintiff showing a conflict or gross negligence, the court will not substitute its judgment if the Board's decision can be attributed to any rational business purpose
 - *Revlon* – Where there is a sale of corporate control, courts will apply enhanced scrutiny
 - Burden is on the directors to prove they have acted reasonably to seek the transaction offering the best value reasonably attainable to the stockholders
 - Becomes a process and context driven inquiry that usually involves a market check of some sort (either pre or post signing) and an increased conditionality on the deal from the buyer's perspective
- So Where is the Line – How much Cash is Too Much?
 - All cash buyout is per se *Revlon*
 - Stock-for-stock transactions are generally not deemed *Revlon* so long as control remains diffuse
 - Case law suggests that the line is likely between 33% and 50%, although the law continues to evolve with one Vice Chancellor recently suggesting that all “end stage” transactions implicate *Revlon*

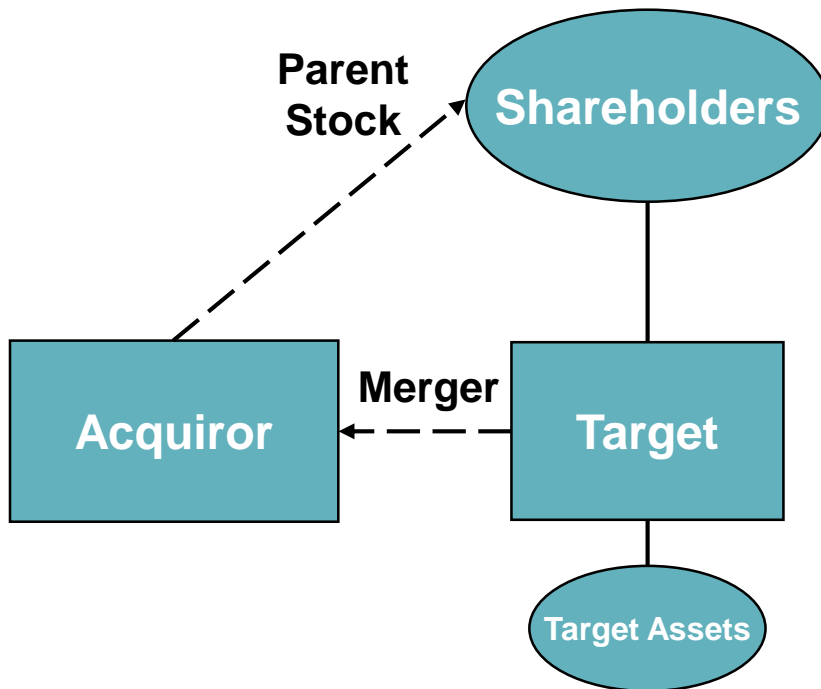
I. FACTORS THAT DRIVE ACQUISITION STRUCTURES

SHAREHOLDER VOTE CONSIDERATIONS

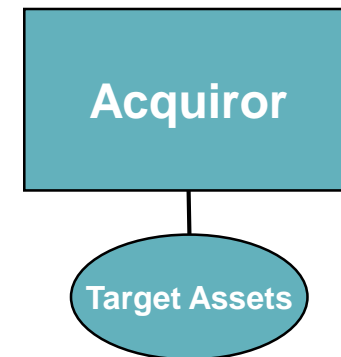
- Target company stockholders likely to have a vote regardless
 - Creates conditionality as the vote may occur months after the deal is inked
 - Leads to heavy negotiations around:
 - When the target board can change its recommendation of the deal
 - The consequences of a “naked no vote”
- Acquirer may have vote under applicable Stock Exchange rules
 - Both the NYSE and Nasdaq require stockholder approval in an M&A transaction where the number of shares issued in the merger is 20% or more of the acquirer’s outstanding common stock or voting power
 - Absent a plaintiff showing a conflict or gross negligence, the court will not substitute its judgment if the Board’s decision can be attributed to any rational business purpose.
 - This introduces similar conditionality concerns raised by the target requirement for a stockholder vote
- Vote considerations can also matter where by charter or by law, a merger requires a super majority vote
 - Forest Oil & Sabine Oil & Gas deal in 2014

II. DEAL STRUCTURES – CORPORATE TARGETS

TAX-DEFERRED REORGANIZATION – “A” MERGER



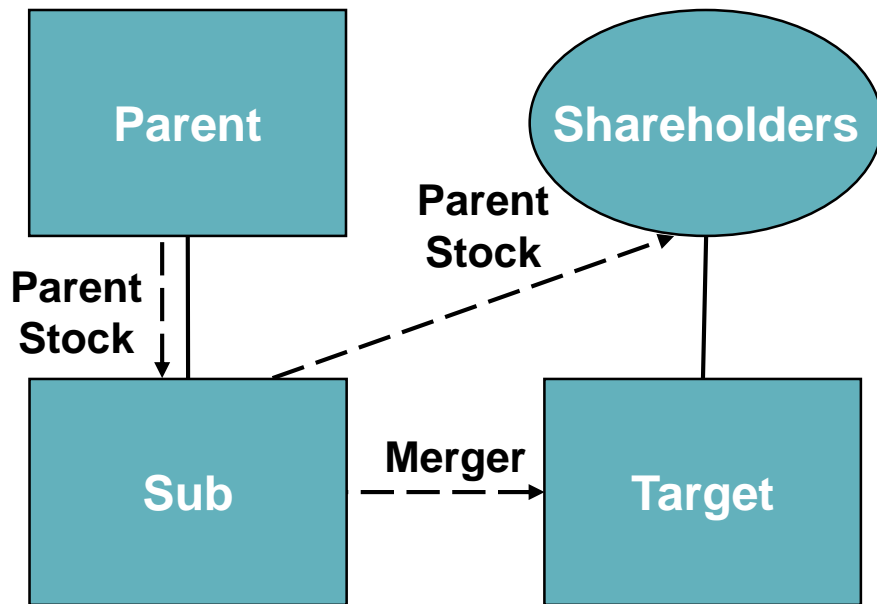
- Most flexible from tax perspective
- Typically requires vote of both companies
- Can have assignment and consent issues
- Liabilities of Target directly assumed by Parent



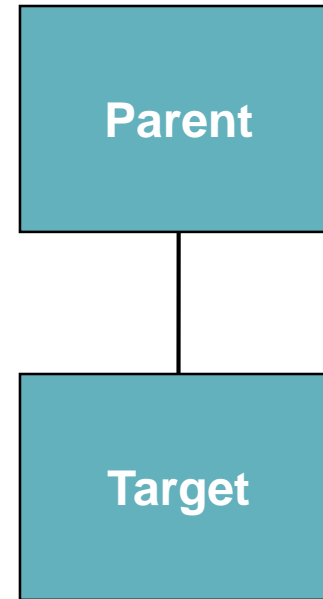
- Statutory Merger
- At least 40% stock consideration (common, preferred, voting or non-voting)
- No “substantially all” requirement

II. DEAL STRUCTURES – CORPORATE TARGETS

TAX-DEFERRED REORGANIZATION – REVERSE TRIANGULAR MERGER



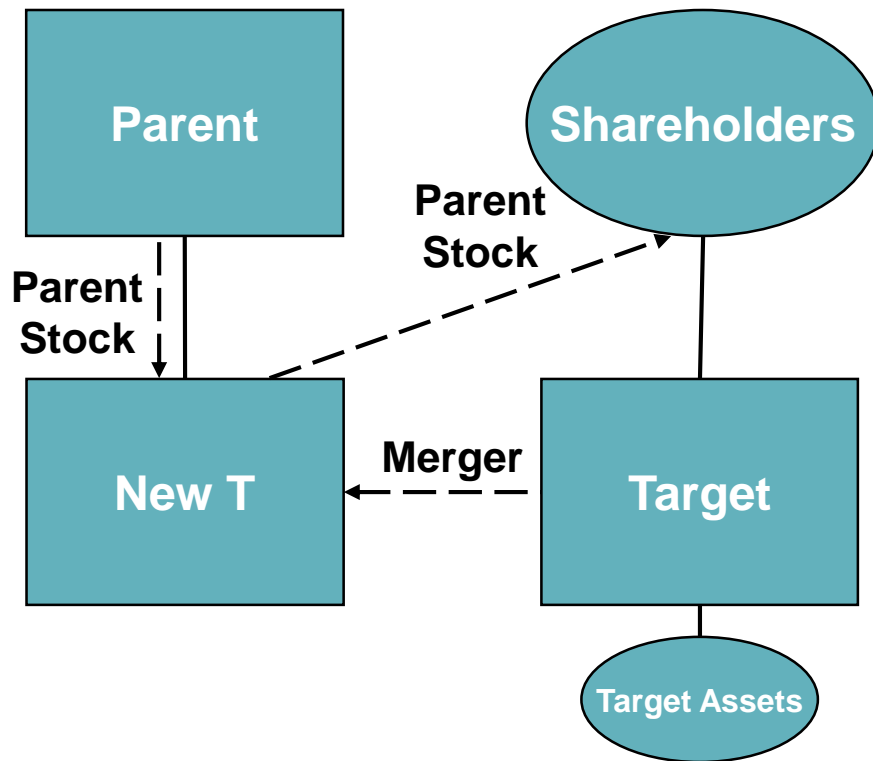
- Most common form
- Corporate law flexibility
 - Target survives
 - May avoid shareholder vote
 - Generally most favorable for assignment and consent issues



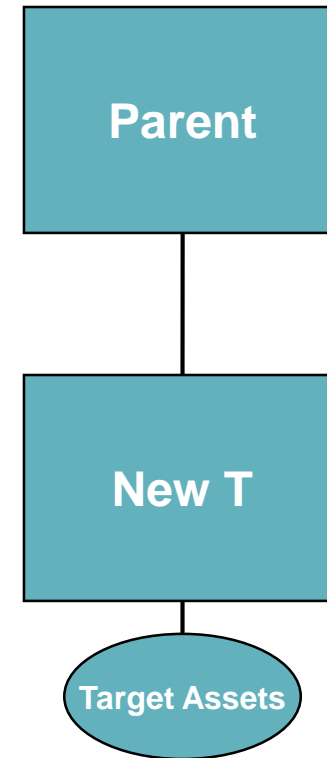
- Must use Parent stock
- At least 80% stock consideration – Target shareholders must surrender stock representing “control” of Target in exchange solely for Parent voting stock
- “Substantially all” requirement – 90% net / 70% gross assets (limits pre-merger distributions)

II. DEAL STRUCTURES – CORPORATE TARGETS

TAX-DEFERRED REORGANIZATION – FORWARD TRIANGULAR MERGER



- May avoid Parent shareholder vote
- Target ceases to exist – can have assignment and consent issues

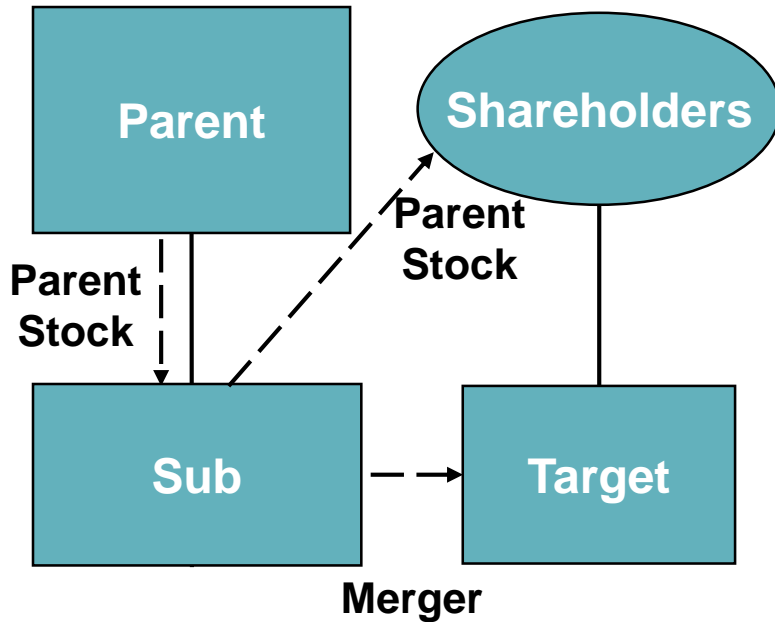


- Must use Parent stock (common, preferred, voting or non-voting)
- “Substantially all” requirement – 90% net / 70% gross assets (limits pre-merger distributions)

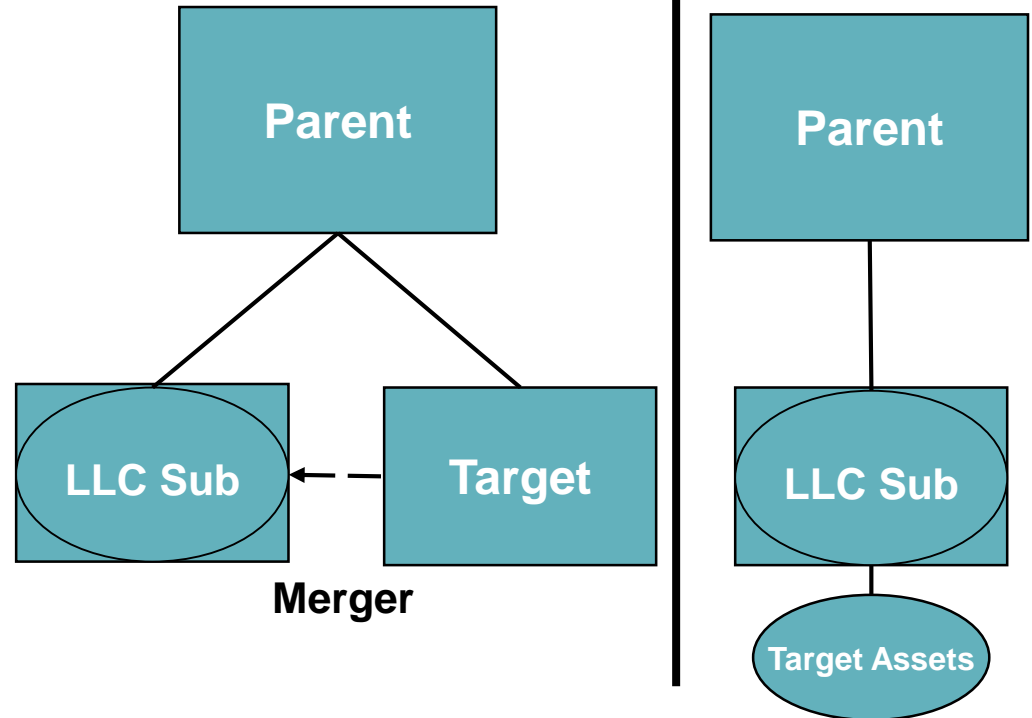
II. DEAL STRUCTURES – CORPORATE TARGETS

TAX-DEFERRED REORGANIZATION – TWO-STEP “A” MERGER

Step 1

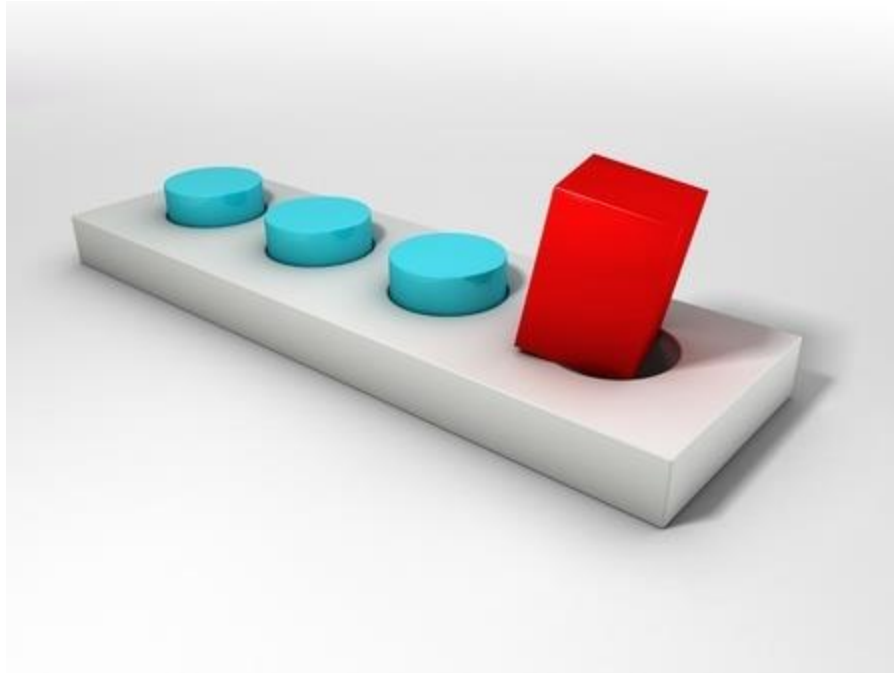


Step 2



- Flexibility of an “A” merger from a tax perspective
- Advantages of forward triangular merger from a corporate law perspective
- Same requirements as a single step A merger
- Second step merger can be into a tax disregarded subsidiary of Parent or into Parent itself

II. DEAL STRUCTURES – CORPORATE TARGETS CAN'T SATISFY TAX-DEFERRED REORGANIZATION REQUIREMENTS



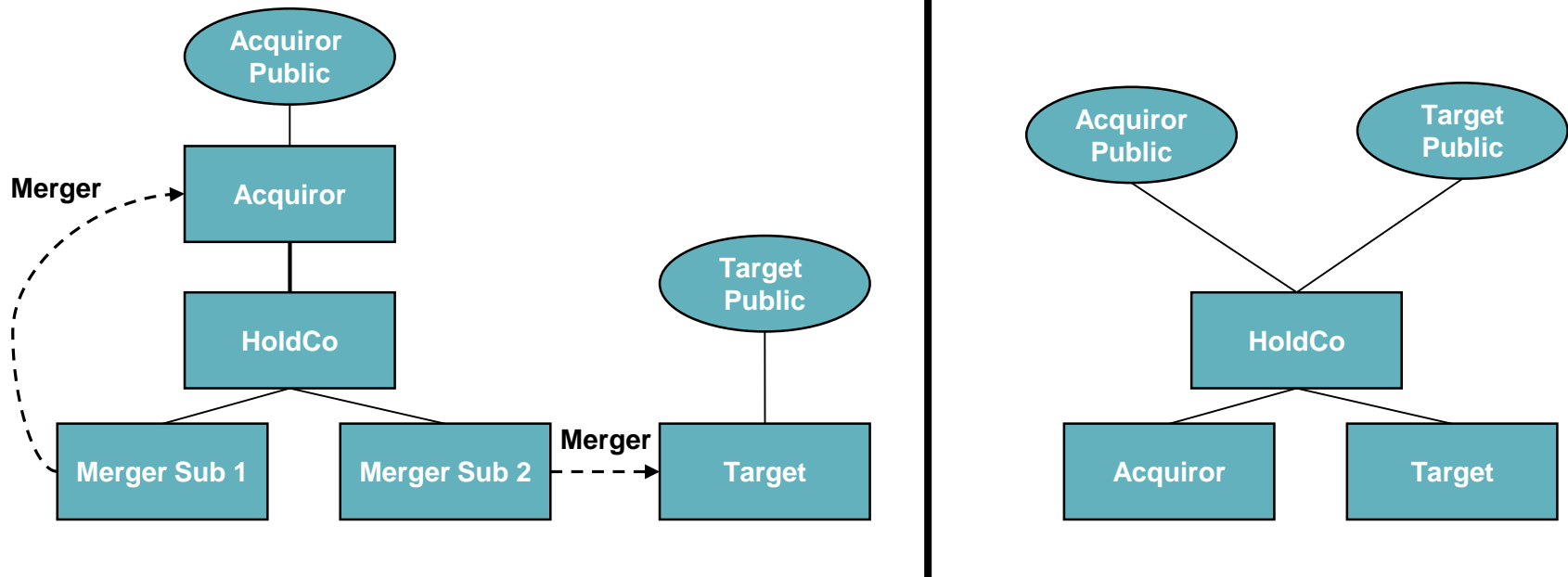
II. DEAL STRUCTURES – CORPORATE TARGETS

DOUBLE DUMMY EXAMPLE

- Proposed Transaction
 - Target owned 70% by PE fund and 30% by Founders
 - Parent wants to acquire Target:
 - All cash to PE fund
 - All Parent stock to Founders
 - Parent will only agree to deal if Founders roll all (or a large portion) of Target interest into Parent equity
 - Founders will only agree to deal if can receive Parent equity on a tax-free basis
- Problems
 - Does not qualify as a tax-deferred reorganization
 - Does not qualify as a “Section 351” transaction

II. DEAL STRUCTURES – CORPORATE TARGETS

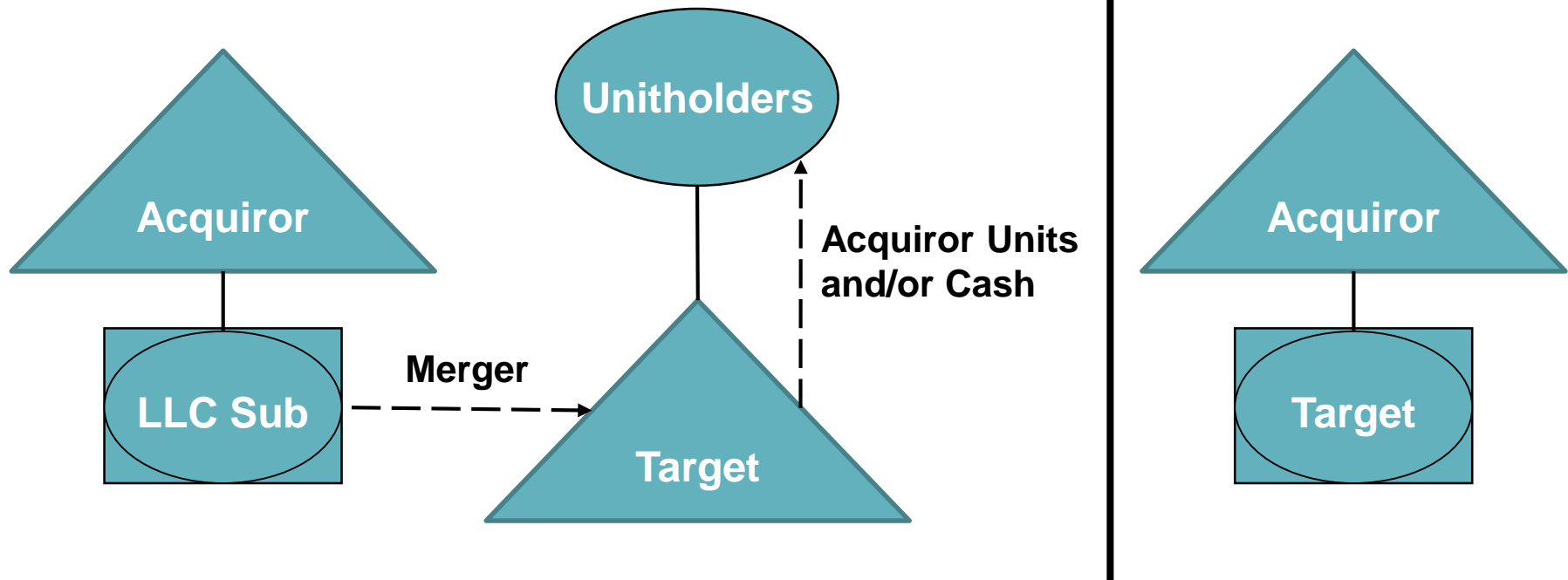
DOUBLE DUMMY STRUCTURE OVERVIEW



- Acquiror forms HoldCo, and Holdco forms Merger Sub 1 and Merger Sub 2;
- Merger Sub 1 merges with and into Acquiror, with Acquiror shareholders receiving shares of Holdco;
- Merger Sub 2 merges with and into Target, with Target shareholders receiving shares of Holdco; and
- Acquiror and Target become wholly-owned subsidiaries of Holdco.

III. DEAL STRUCTURES – PARTNERSHIP TARGETS

PARTNERSHIP ACQUIROR



- For tax purposes, Target treated as contributing all assets/liabilities to Acquiror for merger consideration and then distributing to Target unitholders in complete liquidation.
- In general, no gain or loss is recognized on the contribution of property to a partnership in exchange for an interest in the partnership.
- Gain may be recognized by Target unitholders if cash consideration received or as a result of “debt shifts”.

III. DEAL STRUCTURES – PARTNERSHIP TARGETS

CORPORATE ACQUIROR



III. DEAL STRUCTURES – PARTNERSHIP TARGETS

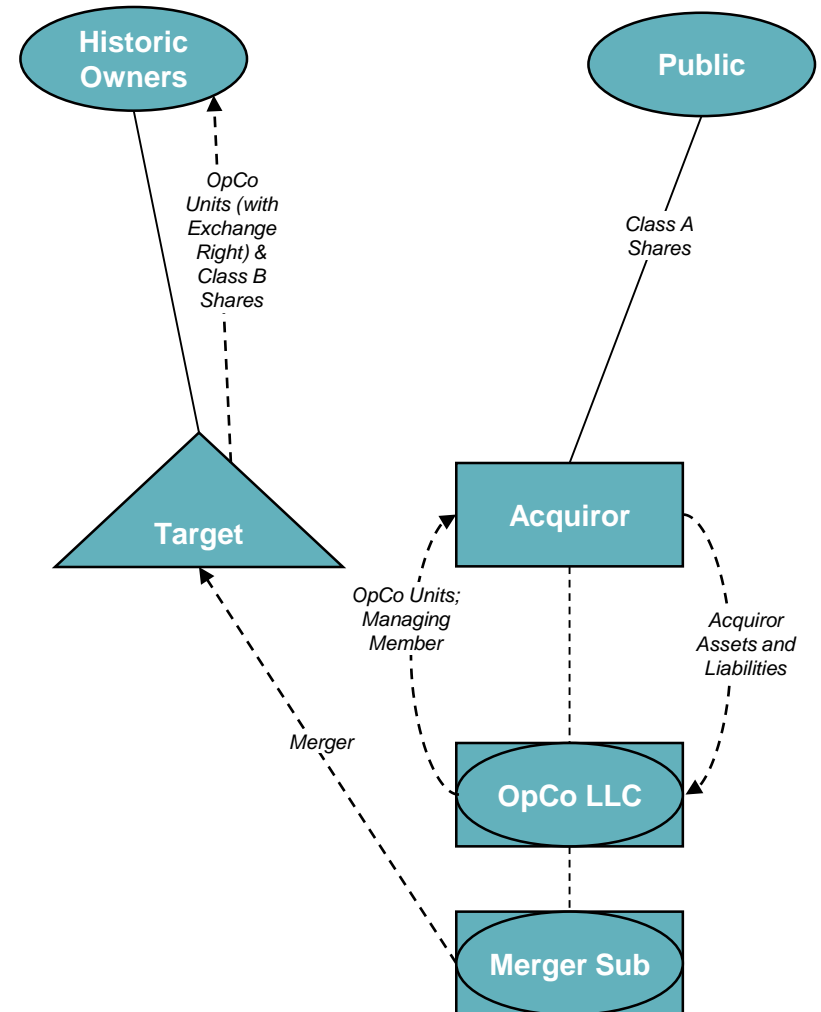
ACQUISITIVE UP-C EXAMPLE

- Proposed Transaction
 - Parent is a corporation
 - Target is taxed as a partnership
 - Parent wants to acquire Target using Parent equity
 - Target owners will only agree to deal if can receive Parent equity on a tax-free basis
- Problems
 - Does not qualify as a tax-deferred reorganization
 - Does not qualify as a “Section 351” transaction

III. DEAL STRUCTURES – PARTNERSHIP TARGETS

UP-C STRUCTURE OVERVIEW

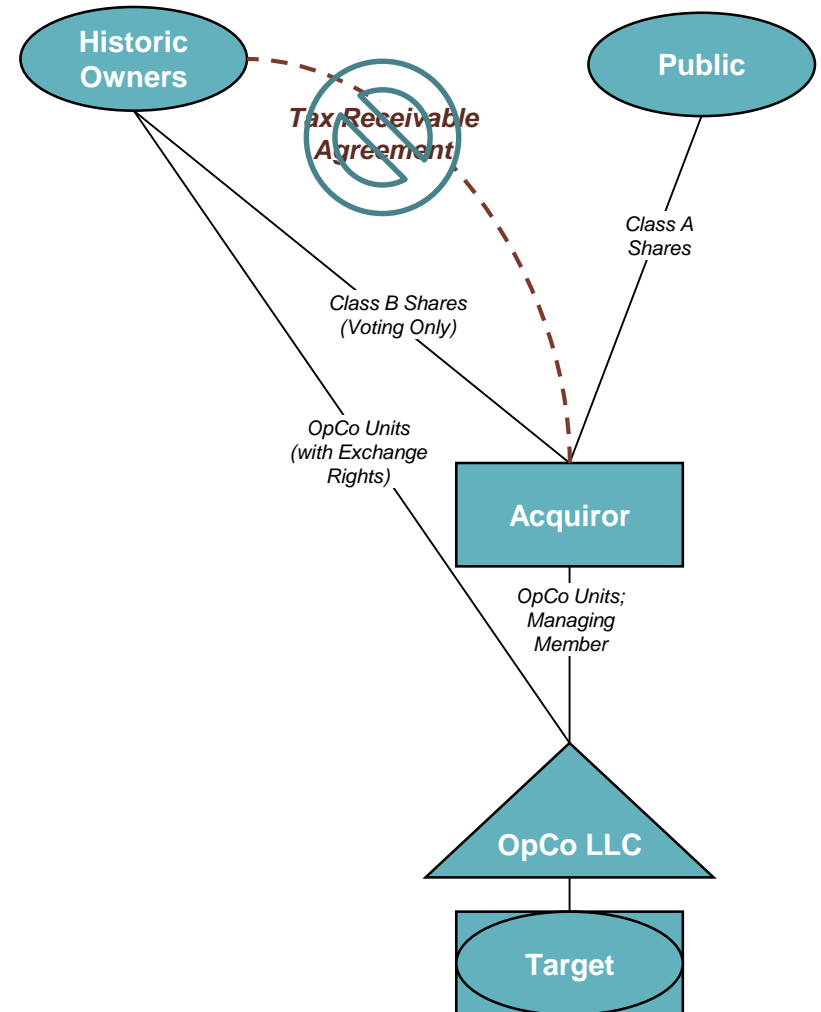
- If Acquiror assets are not already held in a disregarded LLC subsidiary, Acquiror must contribute all of its assets and liabilities to a new LLC subsidiary. Acquiror is managing member of OpCo LLC.
- OpCo LLC forms Merger Sub, which merges with and into Target, with Target surviving the merger. Historic Owners receive exchangeable OpCo Units and non-economic voting Class B Shares of Acquiror in the merger.
- For tax purposes, Acquiror treated as a contributing assets/liabilities to OpCo LLC for OpCo Units.
- For tax purposes, Target treated as contributing all assets/liabilities to Acquiror for merger consideration and then distributing to Target unitholders in complete liquidation.
- In general, no gain or loss is recognized on the contribution of property to a partnership in exchange for an interest in the partnership.
- Gain may be recognized by Historic Owners if cash consideration received or as a result of “debt shifts”. Acquiror may recognize gain as a result of “debt shifts”.



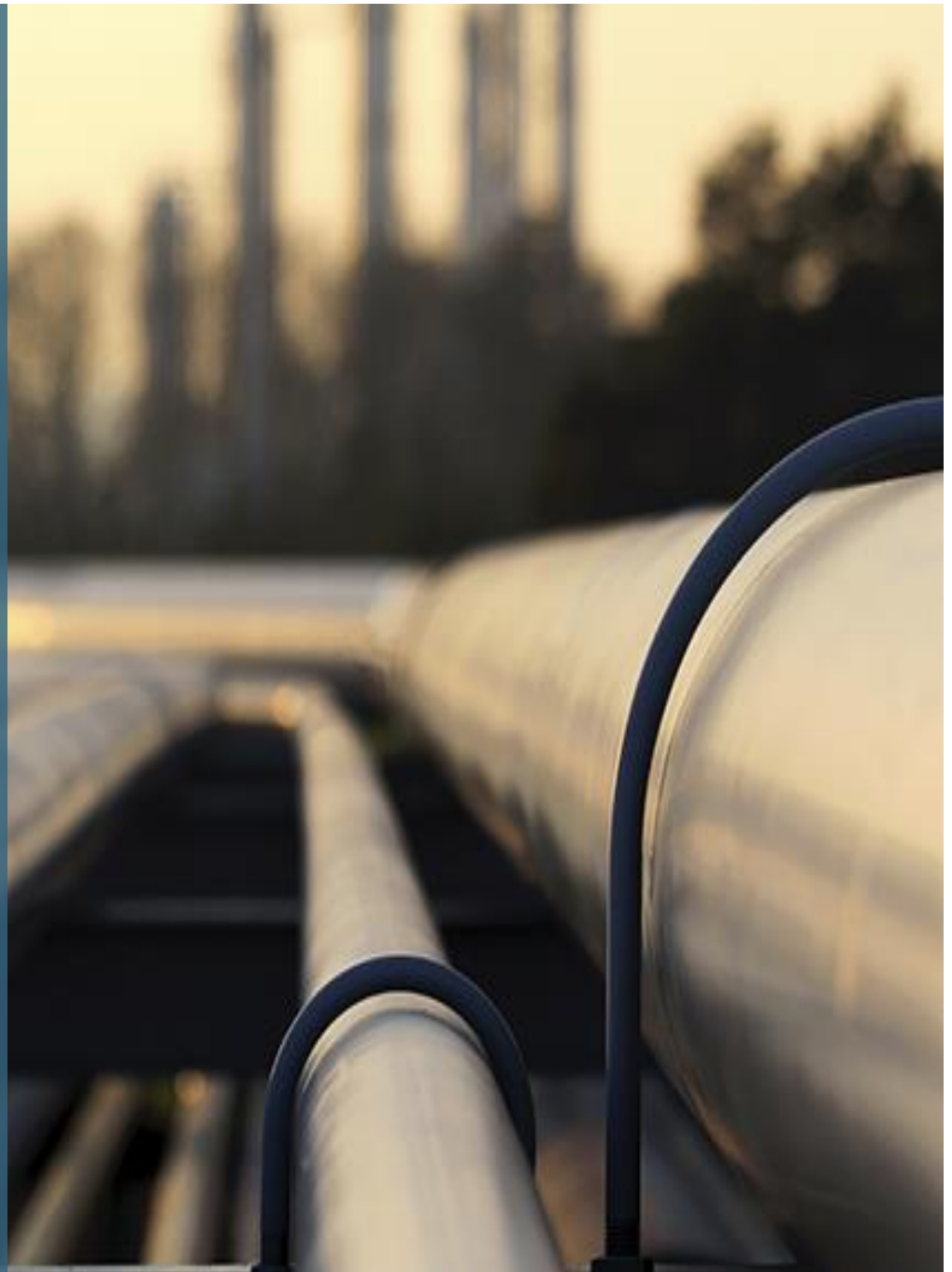
III. DEAL STRUCTURES – PARTNERSHIP TARGETS

UP-C STRUCTURE OVERVIEW

- Acquiror Class A Shares have all economic rights in Acquiror.
- Acquiror Class B Shares have no economic rights, but vote as a class with the Class A Shares. Historic owners hold one Class B Share per OpCo Unit held by them.
- OpCo Units (together with corresponding Class B Shares) may be exchanged for Class A Shares.
- Exchange of OpCo Units (and corresponding Class B Shares) for Class A Shares is a taxable exchange resulting in a basis step-up for Acquiror.
- Typically no tax receivable agreement; Acquiror retains 100% of the tax benefits resulting from the exchange basis step-up.



VANTAGE/RICE CASE STUDY



VANTAGE / RICE BACKGROUND

- Vantage Energy is an upstream company focused on the Appalachian Basin, with an additional sizeable position in the Barnett Shale and was PE-sponsored until its acquisition by Rice Energy. Vantage also owned and operated midstream infrastructure in Appalachia.
 - Vantage filed a confidential IPO registration statement in late July 2016 and made a public filing two weeks prior to this transaction.
- Rice Energy is a publicly traded upstream company with assets in the Appalachian Basin. Rice Energy controls the general partner and a sizeable portion of limited partnership interests in Rice Midstream Partners, a publicly traded MLP.



VANTAGE / RICE

FINANCIAL TERMS

- Enterprise Value of \$2.7 billion (net debt ~\$700 million)
- Cash and Equity
 - Equity piece: lesser of (i) 40 million units and (ii) the number of units that Rice could issue without triggering a stockholder vote (no less than 38 million units)
 - Cash piece: ~\$2 billion less the number of units issued multiplied by \$25
- Equity – Issued at Rice Appalachia (wholly-owned subsidiary of Rice Energy)
 - Convertible into Rice Energy common stock

VANTAGE / RICE

“UP-C” STRUCTURE

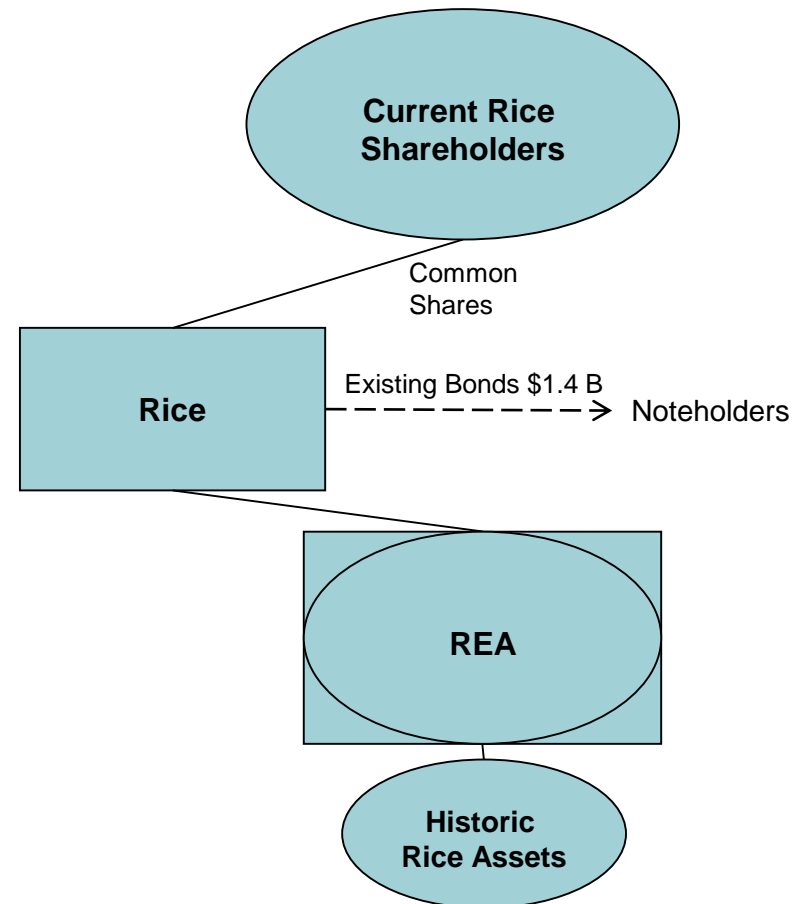
- Rice Energy Inc. (“Rice”) owns equity interests in Rice Energy Appalachia (“REA”), which owns the operating assets. The equity interests in REA not held by Rice are held by the former owners of Vantage (“Vantage Sellers”).
- The owners of Vantage (“Vantage Sellers”) were able to remain in a pass-through structure, and their interests in REA are exchangeable for shares of Rice (or, at Rice’s election, cash).
- Rice will receive a step-up in basis as the Vantage Sellers exchange REA interests for shares of Rice.
- Tax on gain associated with the equity consideration received by the Vantage Sellers will be deferred until the equity interests in REA are exchanged for shares in Rice (or cash).
- Rice (and, in turn, REA) is managed by the board of directors of Rice, which is elected by Rice’s stockholders.
- Members of REA (other than Rice) hold 1/1000th of a non-economic, preferred voting share in Rice for each unit of common equity in REA, which provides them with equivalent voting rights as other stockholders of Rice on an as-converted basis.

TRANSACTION OVERVIEW

STRUCTURE: TRANSACTION STEPS – STEP 1

Step 1

- REA assumes responsibility for the existing public notes of Rice (and any other debt currently at the Rice level) pursuant to an agreement between Rice and REA.



Entity Classification for U.S. Tax Purposes



Partnership



Corporation



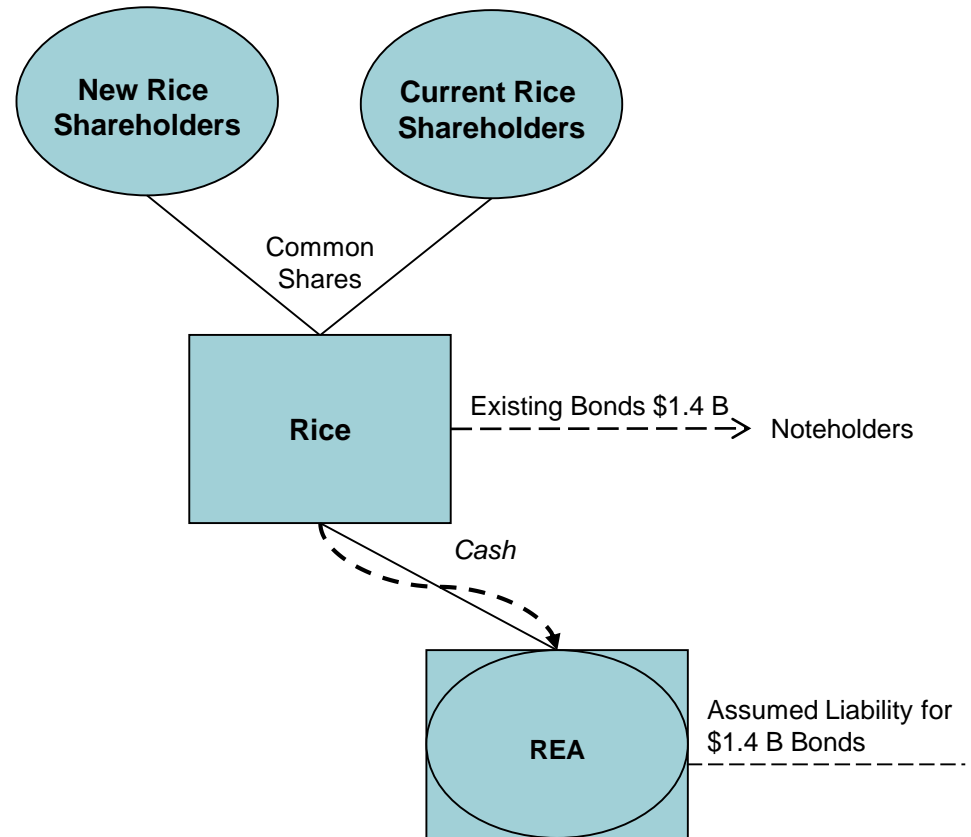
Disregarded entity

TRANSACTION OVERVIEW

STRUCTURE: TRANSACTION STEPS – STEP 2

Step 2

- Rice contributes the net proceeds of a public equity offering to REA.



Entity Classification for U.S. Tax Purposes



Partnership



Corporation



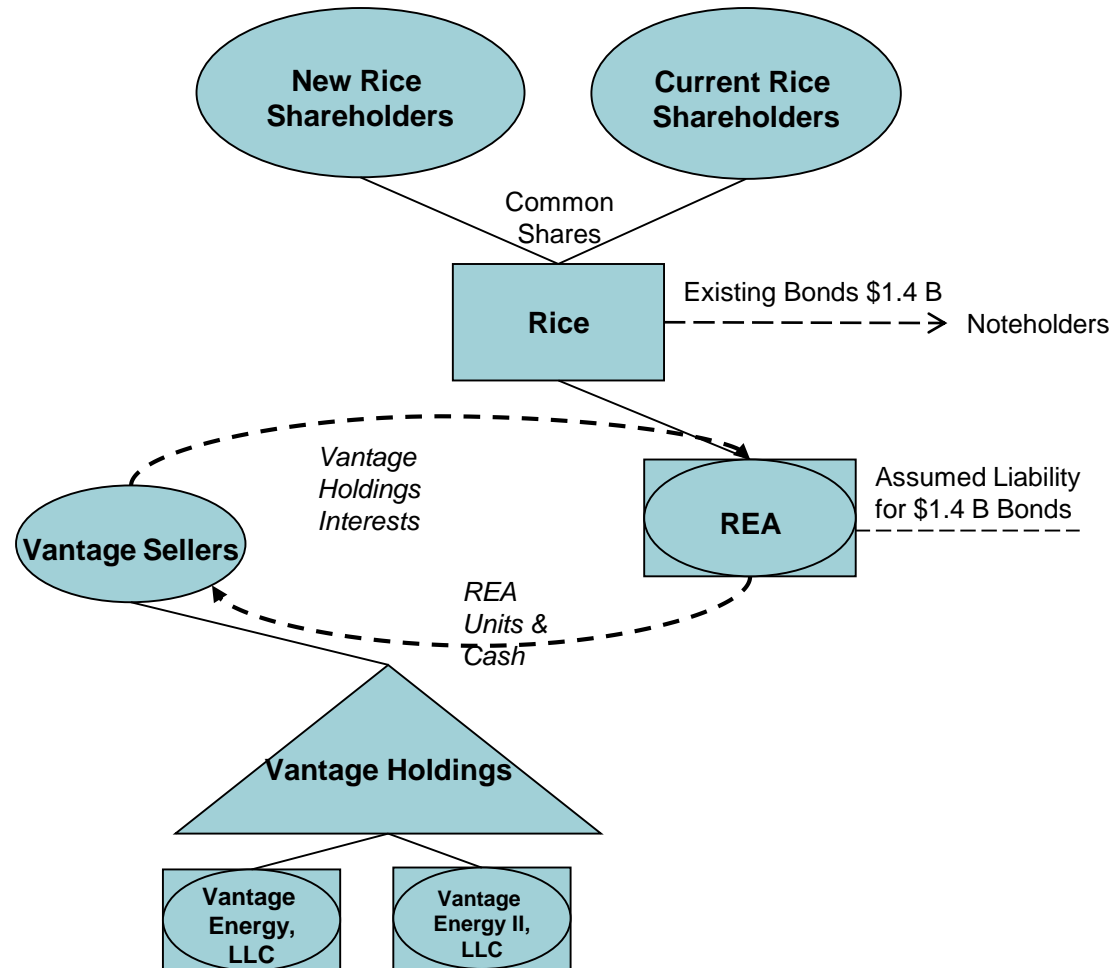
Disregarded entity

TRANSACTION OVERVIEW




STRUCTURE: TRANSACTION STEPS – STEP 3

Step 3

1. The Vantage Sellers contribute all of their interests in Vantage Energy Holdings, LLC (“Vantage Holdings Interests”) to REA in exchange for REA units and cash.
2. The REA units held by the Vantage Sellers are exchangeable for shares of Rice common stock on a one-for-one basis (subject to customary adjustments for stock splits, etc.).

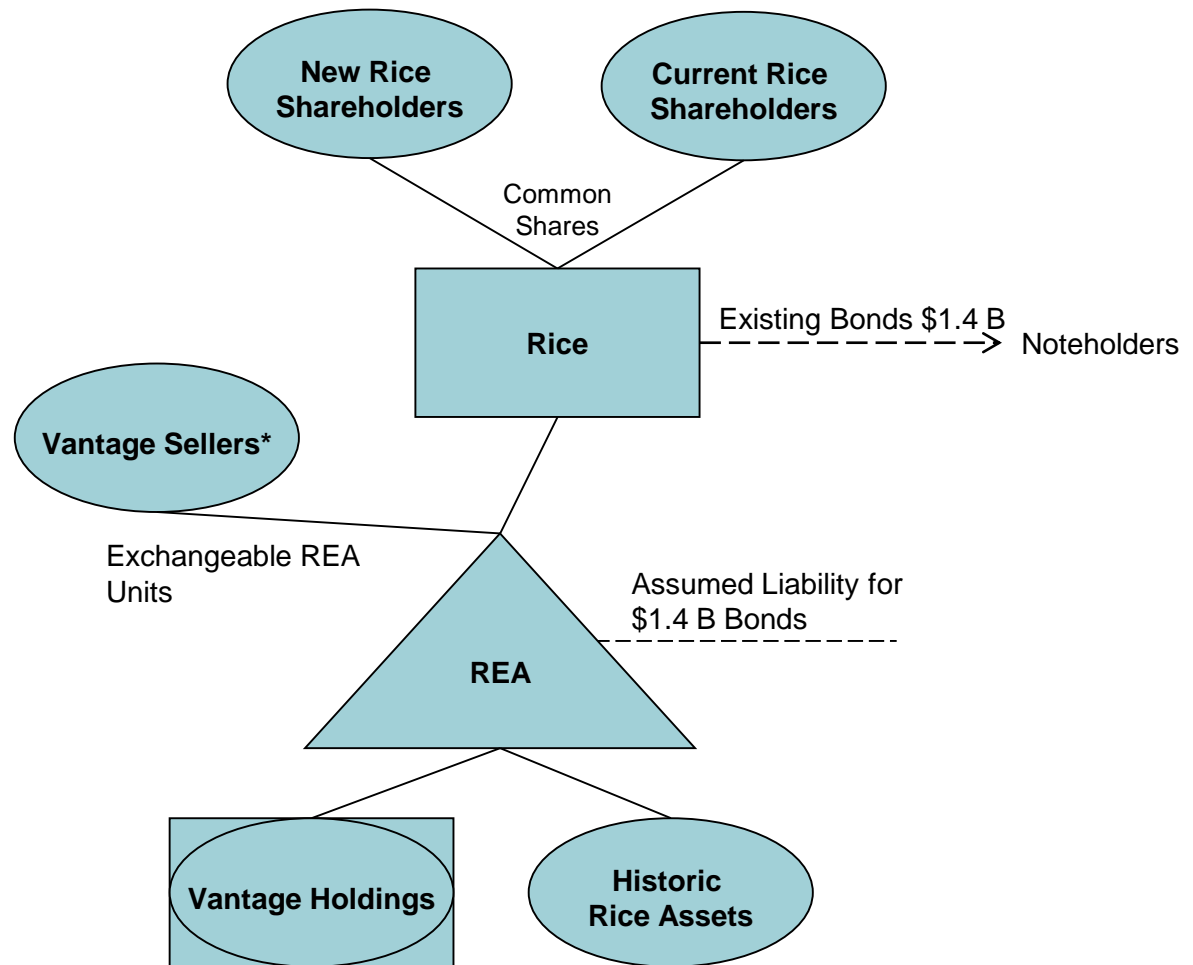


Entity Classification for U.S. Tax Purposes

	Partnership
	Corporation
	Disregarded entity




TRANSACTION OVERVIEW

STRUCTURE: TRANSACTION STEPS – FINAL STRUCTURE



** Also hold non-economic voting Rice preferred shares.*

Entity Classification for U.S. Tax Purposes

	Partnership
	Corporation
	Disregarded entity



THANK YOU

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