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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Difference Between an Asset Purchase and a Stock Purchase

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An asset sale is the purchase of individual assets and liabilities, whereas a stock sale is the purchase of shares of a bank or bank holding company. In connection with the acquisition of a bank by another bank or bank holding company, an important initial consideration is the legal structure that the transaction will take. Determining the transaction structure may be challenging as the buyer and seller often have competing interests and different perspectives.

In an asset purchase, the buyer purchases only those tangible and intangible assets, and assumes only those liabilities, that are specifically identified in the purchase agreement. Buyers often favor this structure for its flexibility. They can pick and choose the assets they wish to acquire and the liabilities they wish to assume, and leave the rest behind. Because the liabilities assumed by the buyer are specifically identified in the purchase agreement, this structure may allow a buyer to avoid contingent or unknown liabilities, although some laws such as environmental, may nonetheless impose liability on the buyer.

The asset purchase structure is often used when the buyer is looking to acquire branch locations of a bank. It can be complex and time consuming, however, due to the extra effort required to identify and transfer every important asset. It is important in an asset purchase transaction that the buyer negotiate representations and warranties concerning the target's business, assets, and liabilities so that it has a complete and accurate understanding of the assets and liabilities to be acquired. While some assets, such as equipment, may easily be transferred by a bill of sale or other instrument of title, other assets, such as intellectual property or real estate, require a separate assignment or deed with different mechanics and formalities. Third-party consents will often be required in order to transfer certain contracts from seller to buyer, as many contracts specifically state they are not assignable or require consent to assign. Since the process of identifying and obtaining consents may take considerable time, the parties should identify all required third-party consents at an early stage of the transaction to avoid delay at closing.

In a stock acquisition, the buyer acquires the target bank's stock from its stockholders. The target bank stays exactly the same with its assets and liabilities unchanged, but with new ownership. It is important in a stock purchase transaction

that the buyer negotiate representations and warranties concerning the target's business, assets, and liabilities so that it has a complete and accurate understanding of the target bank. In most instances the target bank will be owned by a bank holding company which will be the only asset of the bank holding company. In this situation, the buyer will generally acquire both the bank holding company and the target bank with both being merged out of existence on the closing date of the transaction. A stock purchase is generally advantageous for a seller because of the benefit from long-term capital gains tax rates.

One consideration for the buyer is that it will not get 100 percent control of the target bank or the bank holding company unless all stockholders agree to sell their stock. A high number of stockholders increases the risk of hold-outs, protracted negotiations, and other complications. A buyer unable to acquire 100 percent of the stock will be left with minority stockholders who may prove difficult. To combat this risk, a buyer may condition the transaction on 100 percent participation by the stockholders. Since the target bank is simply moving to a new owner, the assets of the target remain unchanged in a stock purchase, and most of the assignment and third-party consent procedures that can cause complications or delays in an asset purchase may be avoided. However, data processing contracts and real estate leases may require consent so it is important that the buyer identify all contracts requiring consent.

In a merger, two banks or bank holding companies combine to form one legal entity, with the stockholders of the target bank or bank holding company receiving stock of the buyer, cash, or a combination of both. The surviving entity assumes all the assets, rights, and liabilities of the extinguished entity by operation of law. Mergers are often structured as "triangular," where the buyer uses a subsidiary (typically one that is newly formed) that will be merged into the target (a reverse triangular merger) or into which the target will merge (a forward triangular merger). An advantage of the triangular merger structure is that the buyer is able to shield itself from the liabilities of the target. A merger transaction is similar to a stock purchase in that the buyer will acquire all of the target's assets, rights, and liabilities (known and unknown). One key advantage of a merger is that it typically requires consent of only a majority of the target's stockholders (subject to any additional requirements existing in a target's organizational documents). This makes merger a good choice (and often the only practical choice) where the target has numerous stockholders or has stockholders opposed to the transaction. Under state laws, target stockholders who are opposed to a transaction will generally have the right to dissent and exercise appraisal rights to receive the "fair value" for their stock as determined by a court.

Since every purchase and sale of a bank involves a unique set of circumstances, it is important to closely analyze each transaction to determine whether a stock purchase or an asset purchase is more desirable to a particular party based upon the bank regulatory requirements and other factors. Selecting the best structure to is critical to the success of any acquisition. Transaction structure may be complicated, and the benefits of a structure for one party may work to the disadvantage of the other party. Therefore, both the parties and their attorneys must weigh the competing legal, tax, and business considerations and creatively construct the most mutually advantageous transaction structure.

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