May 13, 2005

The Honorable Mark W. Everson
Commissioner of Internal Revenue
Internal Revenue Service
Room 3000 IR
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Proposed Regulations Regarding the Effect of Pre-Closing Changes in Acquiring Corporation Stock Value on Continuity of Interest (REG-129706-04)

Dear Commissioner:

Enclosed are comments on proposed regulations regarding the effect of pre-closing changes in acquiring corporation stock value on continuity of interest. These comments represent the individual views of those members who prepared them and do not represent the position of the American Bar Association or of the Section of Taxation.

Sincerely,

Kenneth W. Gideon
Chair, Section of Taxation

Enclosure

cc: Eric Solomon, Deputy Assistant Secretary (Regulatory Affairs) and Acting Deputy Assistant Secretary, Treasury
    Donald L. Korb, Chief Counsel, IRS
    Helen M. Hubbard, Tax Legislative Counsel, Treasury
    Nicholas J. DeNovio, Deputy Chief Counsel (Technical) IRS
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    Jeffrey B. Fienberg, Attorney, Office of the Associate Chief Counsel (Corporate) Branch 2, IRS
COMMENTS ON PROPOSED REGULATIONS REGARDING THE EFFECT OF PRE-CLOSING CHANGES IN ACQUIRING CORPORATION STOCK VALUE ON CONTINUITY OF INTEREST (REG-129706-04)

The following comments represent the individual views of members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation.

These comments were prepared by individual members of the Committee on Corporate Tax of the Section of Taxation. Principal responsibility was exercised by John Sweet and Bob Woodward. Substantive contributions were made by Julie Divola, Richard Nugent, Stuart Offer, Mark Silverman, David Strong and David Wheat. The comments were reviewed by Bob Wellen of the Section of Taxation’s Committee on Government Submissions and by Mark Yecies, Council Director for the Corporate Tax Committee.

Although the members of the Section of Taxation who participated in preparing this report have clients who would be affected by the federal tax principles addressed by the report, or have advised clients on the application of these principles, no such member (or firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these Comments.

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Date: May 13, 2005
Executive Summary

Under the Proposed Regulations regarding the effect of pre-closing changes in acquiring corporation stock value on continuity of interest (REG-129706-04) (“Proposed Regulations”), continuity of interest (“COI”) would be measured based on the value of acquiring corporation stock as of the end of the last business day before the first date there is a binding agreement to affect a potential reorganization (“Signing Date Value”), provided that the consideration is fixed in the agreement and includes only acquiring corporation stock and cash.\(^1\) We strongly support the adoption of a signing date approach. It would eliminate uncertainty with respect to the effect on COI of changes in the value of acquiring corporation stock between signing and closing and, correspondingly, would eliminate the need to include mechanisms in the agreement solely to ensure satisfaction of the COI requirement in the event of a decline in acquiring corporation stock value (e.g., additional stock consideration, reduced cash consideration, alternative transaction structures, or some combination of each).

Although the Proposed Regulations would improve the administrability of the COI requirement by providing for the measurement of COI by reference to Signing Date Value in certain cases (as opposed to closing date value, which is the current practice), we believe the circumstances under which a signing date approach may be used should be significantly expanded. We believe that this can be done in a manner that is consistent with the stated purpose of the COI requirement “to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations.”\(^2\) Our specific recommendations (which are discussed in more detail below) include:

1. Clarifying the acceptable methods for determining Signing Date Value;
2. Expanding the permissible types of consideration to include items of non-cash boot;
3. Revising the definition of fixed consideration to (a) clarify the requirement that an agreement state the number of acquiring corporation shares and the amount of cash to be exchanged for target corporation shares, (b) address implications of dissenters’ rights, cash in lieu of fractional shares and certain changes in the capitalization of the acquiring or target corporation, and (c) clarify the safe harbor with respect to acquiring corporation stock or cash placed in escrow;
4. Providing a safe harbor signing date approach for cases in which the number of acquiring corporation shares or amount of cash is not fixed, but the minimum number of acquiring corporation shares and maximum amount of cash that may be exchanged on the closing date for target corporation shares can be determined under the terms of the agreement;

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\(^1\) Prop. Reg. § 1.368-1(e)(2)(i).
\(^2\) Treas. Reg. § 1.368-1(e)(1)(i).
5. Revising the proposed treatment of modifications that relate to the amount or type of consideration to be provided to target corporation shareholders; and

6. Providing immediate guidance with respect to the simple cases where there is a binding agreement that provides for a fixed amount of consideration consisting solely of acquiring corporation stock and cash.

We are not making a recommendation at this time regarding the application of the COI requirement to arrangements in which the number of shares of acquiring corporation stock or the amount of cash or other consideration to be received by target corporation shareholders is contingent on post-closing events.

**Discussion of Recommendations**

1. **Signing Date Valuation of Acquiring Corporation Stock**

   In transactions to which the Proposed Regulations would apply, the value of acquiring corporation stock for COI purposes would be its Signing Date Value (i.e., its value as of the end of the last business day prior to the signing date).\(^3\) It is not entirely clear how end-of-the-day value should be determined for this purpose. The examples in the Proposed Regulations look to the trading price of acquiring corporation stock at the end of the last business day before the signing date, but there may be uncertainty about this value where an acquiring corporation’s stock is traded both on and off an exchange or on multiple exchanges. Where there are multiple closing prices for an acquiring corporation’s stock, we recommend that the final regulations permit COI to be measured using the highest closing price on any established securities market that trades the stock.\(^4\)

   In addition, we believe that commercially reasonable averaging conventions (such as a high-low average on the relevant date),\(^5\) which may provide a more reliable indication of acquiring corporation stock value than a single end-of-the-day trading price, should also be acceptable for this purpose in cases where the acquiring corporation stock is publicly traded. We note in this regard that contracting parties sometimes use an averaging convention covering several days prior to the signing date (e.g., ten trading days) to determine the amount of consideration to be provided to target corporation shareholders; the purpose of such a convention is to minimize the impact of fluctuations immediately prior to the signing date that might result from leaks about the pending negotiations or from unrelated events affecting the market as a whole.

2. **Transactions Involving Non-Cash Boot**

   The signing date approach set forth in the Proposed Regulations would apply only if the consideration to be delivered in exchange for stock of the target corporation is fixed

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\(^3\) Prop. Reg. § 1.368-1(e)(2)(i).

\(^4\) Cf. Treas. Reg. § 1.7704-1(b) (defining “established securities market” for purposes of Section 7704(b) of the Internal Revenue Code); Treas. Reg. § 1.1273-2(f) (describing the circumstances under which a debt instrument will be treated as “traded on an established securities market” for purposes of Section 1273 of the Internal Revenue Code).

and consists solely of acquiring corporation stock and cash.\(^6\) This limitation on acceptable types of consideration may reflect a concern that other types of consideration (e.g., debt instruments or warrants) would be difficult to value. However, such valuation difficulties generally would exist regardless of the time at which COI is measured. We believe that, in measuring COI, the policy supporting the use of Signing Date Value for stock is equally applicable to other property to be delivered at closing. We also believe that limiting a signing date approach to transactions that involve only acquiring corporation stock and cash would unduly hinder transactions that require seller financing. Accordingly, we recommend expanding the permissible types of consideration to include property in addition to acquiring corporation stock and cash, and to allow non-cash boot to be valued at the signing date as well.\(^7\) If there is a concern that an open-ended rule (providing for the signing date valuation of all consideration) would create the potential for abuse or would otherwise be inappropriate, the final regulations could list other types of property (for example, the acquiring corporation’s indebtedness and stock warrants and options) that would be subject to valuation as of the signing date and would not make the signing date rule inapplicable.\(^8\)

3. Definition of Fixed Consideration

a. General Requirement that Agreement State Number of Shares and Amount of Cash. To meet the fixed consideration requirement under the Proposed Regulations, the agreement generally must state the number of shares of acquiring corporation stock and the amount of cash to be exchanged for stock of the target corporation.\(^9\) The preamble indicates that the agreement must specify the “exact” number of shares and the “exact” amount of cash. We assume these references are to the number of shares and amount of cash to be delivered in exchange for target corporation stock on an aggregate (rather than per share) basis.\(^10\) However, acquisition agreements frequently do not state the aggregate number of acquiring corporation shares or aggregate amount of cash to be exchanged for stock of the target corporation. In many cases, it is not possible, as of the signing date, to determine with certainty the total number of shares of acquiring corporation stock or total amount of cash that will be exchanged for target corporation shares. For example, the number of target corporation shares outstanding often increases

\(^6\) Prop. Reg. § 1.368-1(e)(2)(i).

\(^7\) Regarding the signing date valuation of debt instruments, we note by way of comparison that the amount realized with respect to certain debt instruments issued in consideration for the sale or exchange of property may in some cases be determined by reference to interest rates in effect during the three-month period ending with the first month in which there is a binding written contract, rather than the month in which the sale or exchange is ultimately consummated. See Treas. Reg. §§ 1.1001-1(g)(1), 1.1274-2 and 1.1274-4(a).

\(^8\) If the scope of permissible consideration is expanded, references in the subsequent sections to cash generally should be read as including references to other types of permissible non-stock consideration.


\(^10\) See Prop. Reg. § 1.368-1(e)(7)(i), Examples 10 and 11 (referring to the number of acquiring corporation shares and amount of cash to be exchanged “for all of the outstanding stock” of the target corporation).
as a result of the exercise of stock options by target corporation employees between signing and closing. Accordingly, we do not believe it is practical to require that an agreement specify the total number of shares and total amount of cash to be exchanged for stock of the target corporation in order for the consideration to be treated as fixed.

An alternative would be to treat consideration as fixed if the aggregate number of acquiring corporation shares and aggregate amount of cash to be exchanged for target corporation shares can be determined under the terms of the agreement based on the number of target corporation shares outstanding as of the signing date. We do not believe that the possibility that additional target corporation shares may be issued between signing and closing should preclude the use of a signing date approach to determine COI, provided the newly issued target corporation shares would have the same rights with respect to the receipt of merger consideration as shares outstanding on the signing date.

**Example 1 (Base Case).** A merger agreement provides that each target corporation share will be exchanged for .80 shares of acquiring corporation stock and $1.20 cash. The Signing Date Value of the acquiring corporation stock is $1 per share, and as of the signing date, 100 shares of target corporation stock are outstanding. Based on the number of target corporation shares outstanding as of the signing date, target corporation shareholders would receive, in the aggregate, 80 shares of acquiring corporation stock and $120 cash. Because the aggregate number of shares of acquiring corporation stock and the aggregate amount of cash to be exchanged for target corporation shares is determinable under the terms of the agreement (based on the number of outstanding target corporation shares as of the signing date), the fixed consideration requirement is met under the alternative test set forth above.

This test also should be met in a typical shareholder election merger where the merger agreement permits target corporation shareholders to elect to receive either a fixed number of acquiring corporation shares or a fixed amount of cash (or a specified combination of stock and cash) in exchange for each share of target corporation stock. These agreements allow election subject to a proration mechanism that ensures a fixed percentage of outstanding target corporation stock will be exchanged for acquiring corporation stock and a fixed percentage of outstanding target corporation stock will be exchanged for cash.

**Example 2 (Shareholder Election -- Stock and Cash Percentages Fixed).** A merger agreement permits target corporation shareholders to elect to receive, in exchange for each share of target corporation stock, (i) 2 shares of acquiring corporation stock, (ii) $2 cash or (iii) 1 share of acquiring corporation stock and $1 cash. The agreement includes a proration mechanism ensuring that 40 percent of outstanding target corporation stock will be exchanged for acquiring corporation shares and 60 percent of outstanding target corporation stock will be exchanged for cash. The acquiring corporation stock has a Signing Date Value of $1 per share, and as of the signing date, 100 shares of target
corporation stock are outstanding. Based on the number of target corporation shares outstanding as of the signing date, target corporation shareholders would receive, in the aggregate, 80 shares of acquiring corporation stock and $120 cash. Accordingly, as in Example 1, the alternative test for fixed consideration set forth above is met.

If an additional 10 shares of target corporation stock were issued prior to closing under the facts of Example 1 or Example 2, target corporation shareholders would receive, in the aggregate, 88 acquiring corporation shares and $132 cash. This illustrates that the ratio of the number of acquiring corporation shares to cash that is established as of the signing date under the agreement would not change as a result of the issuance of new target corporation shares. Under these circumstances, we believe measurement of COI using a signing date approach is appropriate.

b. Special Rule for Shareholder Elections Where Agreement Provides for Minimum Number of Shares and Maximum Amount of Cash. The Proposed Regulations also include a special rule in the case of shareholder elections under which consideration would be treated as fixed, notwithstanding the general rule, if the agreement states the minimum number of acquiring corporation shares and the maximum amount of cash that may be exchanged for target corporation shares.11 As an initial matter, we do not see any policy justification for limiting this special rule to transactions involving shareholder elections and recommend that it apply to other transactions as well. Consistent with the alternative described above with respect to the general rule regarding fixed consideration, this special rule could be modified to provide that consideration would be treated as fixed (without regard to whether there is a shareholder election) if the minimum number of acquiring corporation shares and the maximum amount of cash that may be exchanged for target corporation shares can be determined under the terms of the agreement based on the number of target corporation shares outstanding as of the signing date.12

Example 3 (Shareholder Election -- Cash Percentage Capped). A merger agreement permits target corporation shareholders to elect to receive, in exchange for each share of target corporation stock, (i) 2 shares of acquiring corporation stock, (ii) $2 cash or (iii) 1 share of acquiring corporation stock and $1 cash. The agreement includes a proration mechanism ensuring that no more than 60 percent of outstanding target corporation stock will be exchanged for cash. The acquiring corporation stock has a Signing Date Value of $1 per share, and as of the signing date, 100 shares of target corporation stock are outstanding. In this case, the minimum number of acquiring corporation shares that may be exchanged for outstanding target corporation shares (based on the number of target corporation shares outstanding as of the signing date) would be 80 and the maximum amount of cash would be $120.

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12 In Section 4 below, we discuss certain issues regarding the measurement of COI in these cases.
Accordingly, the consideration would be treated as fixed under the mechanism described above.13

c. **Other Factors Potentially Affecting Merger Consideration.** Even if one were to assume no variation in the number of target corporation shares outstanding between signing and closing, the aggregate number of acquiring corporation shares and amount of cash to be received by target corporation shareholders still may be subject to some uncertainty where (i) target corporation shareholders have dissenters’ rights, (ii) cash will be paid in lieu of issuing fractional shares of acquiring corporation stock, or (iii) the number of shares of acquiring corporation stock to be delivered in exchange for target corporation stock is subject to adjustment under the agreement to take into account changes in the capitalization of the acquiring or target corporation (e.g., stock splits) occurring between signing and closing. We do not believe the possibility of such cash payments or share adjustments should preclude the use of a signing date approach to determine COI. Accordingly, we recommend disregarding the possibility of such cash payments and share adjustments for the purpose of determining whether consideration is treated as fixed under the tests discussed above.14 We believe this recommendation would make the fixed consideration standard more workable without creating any significant potential for abuse or undermining the purpose of the COI requirement.

d. **Consideration Placed in Escrow to Secure Representations of Target Corporation and its Shareholders.** Under the Proposed Regulations, placing part of the acquiring corporation stock or cash in escrow to secure customary target corporation representations and warranties would not prevent consideration from being fixed.15 Since we do not see a reason in this context to distinguish between customary representations and warranties, on the one hand, and customary covenants, on the other hand, we recommend that acquiring corporation stock or cash placed in escrow to secure performance of customary covenants of the target corporation or its former shareholders similarly not prevent consideration from being fixed.

4. **Alternative Signing Date Approach Where Agreement Provides for Minimum Number of Shares and Maximum Amount of Cash**

a. **General.** In Section 3.b. above, we discussed a possible rule (based on a similar rule in the Proposed Regulations) under which consideration would be treated as fixed, without regard to whether there is a shareholder election, if the minimum number of acquiring corporation shares and the maximum amount of cash that may be exchanged for target corporation shares can be determined under the agreement based on the number of target corporation shares outstanding as of the signing date. Under the Proposed Regulations’ formulation of this rule, COI would be determined based upon the

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13 The issuance of additional target corporation shares prior to closing would not affect the minimum shares/maximum cash ratio. For example, if an additional 10 shares of target corporation stock were issued, the minimum number of acquiring corporation shares would be 88 and the maximum amount of cash would be $132.

14 To the extent any such cash payments are made and are properly treated as boot, they should be taken into account as such in the computation of COI.

assumption that target corporation shareholders will receive the minimum number of acquiring corporation shares and the maximum amount of cash allowable under the agreement.\textsuperscript{16}

In general, we agree with the approach of the Proposed Regulations, which is designed to produce a calculation resulting in the lowest possible COI percentage in situations where the number of acquiring corporation shares and/or amount of cash is subject to a limited amount of variation (i.e., variation subject to a floor in the case of shares and variation subject to a ceiling in the case of cash). The assumptions regarding calculation of COI may, however, need adjustment to produce more appropriate valuation results in certain situations (some of which are described below).

b. Collar and Cash Top-Up Arrangements. Consider, for example, transactions in which the stock or cash to be exchanged for target corporation shares is subject to variation based on changes in the trading price of the acquiring corporation stock between signing and closing (as in a collar or cash top-up arrangement). In these cases, use of the Signing Date Value of acquiring corporation stock seems inappropriate because payment of the minimum number of acquiring corporation shares or maximum amount of cash generally would occur only in cases in which the price of acquiring corporation stock has moved from its Signing Date Value.

Example 4 (Collar Arrangement). An acquiring corporation and a target corporation enter into an agreement providing for the merger of the target corporation into the acquiring corporation. As of the signing date, 100 shares of target corporation stock are outstanding. Acquiring corporation stock has a Signing Date Value of $1 per share. For each share of target corporation stock, target corporation shareholders will receive $1.20 in cash and (i) a number of shares of acquiring corporation stock worth $.80 if the closing date price of a share of acquiring corporation stock is worth at least $.90 and not more than $1.10, (ii) .888 shares of acquiring corporation stock if the closing date price of a share of acquiring corporation stock is below $.90 or (iii) .7273 shares of acquiring corporation stock if the closing date price of a share of acquiring corporation stock is greater than $1.10. Under these facts the minimum number of acquiring corporation shares that may be exchanged for all of the target corporation shares (based on the number of target corporation shares outstanding as of the signing date) is 72.73 and the maximum amount of cash that may be exchanged for target corporation shares is $120. Therefore, the consideration would be treated as fixed under the rule described in Section 3.b. However, measuring COI by valuing 72.73 shares of acquiring corporation stock by reference to the Signing Date Value of $1 per share -- as seems required under the Proposed Regulations (assuming a shareholder election were involved) -- does not make sense because 72.73 shares will be deliverable.

under the agreement only if the closing date price of acquiring corporation stock equals \(^{17}\) or exceeds $1.10 per share. In other words, there is no rational relationship between the minimum number of acquiring corporation shares and the Signing Date Value of $1 per share.

**Example 5 (Cash Top-Up Arrangement).** There are 100 shares of target corporation stock outstanding as of the signing date, and acquiring corporation stock has a Signing Date Value of $1 per share. The merger consideration per target corporation share will consist of (i) .80 shares of acquiring corporation stock and (ii) an amount of cash equal to $1 plus .80 times the excess, if any (but not to exceed $.10), of $1 over the closing date price of a share of acquiring corporation stock. Under these facts the minimum number of shares that may be exchanged for target corporation shares (based on the number of target corporation shares outstanding as of the signing date) is 80 and the maximum amount of cash that may be exchanged for target corporation shares is $108. As in Example 4, measuring COI by reference to the Signing Date Value of acquiring corporation stock -- as seems required under the Proposed Regulations (assuming a shareholder election were involved) -- seems inappropriate because the minimum shares/maximum cash consideration (80 shares and $108 cash) does not reflect the mix of consideration (80 shares and $100 cash) that would be payable if the closing date price of acquiring corporation stock were equal to its Signing Date Value.

An alternative signing date rule in these cases in which the stock or cash consideration varies over a specified range of values of acquiring corporation stock would be to measure COI using the value of the acquiring corporation stock in that range (and corresponding number of shares and amount of cash) that would yield the lowest COI percentage (the “Lowest COI Method”). In the collar arrangement described in Example 4, in which all values within the range would produce the same share consideration value and thus yield the same COI percentage, the Lowest COI Method could apply by measuring COI by reference to any value of acquiring corporation stock within the range (and the number of acquiring corporation shares corresponding to that value). The resulting COI percentage in Example 4 would be 40 percent (equal to $80 value of acquiring corporation shares divided by total consideration of $200). In the cash top-up arrangement described in Example 5, the Lowest COI Method would entail using the acquiring corporation stock value at the low end of the range, which would correspond to the maximum amount of cash consideration. The resulting COI percentage in Example 5 would also be 40 percent (equal to $72 value of acquiring corporation shares divided by total consideration of $180).

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\(^{17}\) If the closing price of acquiring corporation stock is $1.10 per share, target corporation shareholders would be entitled to receive consideration per target corporation share consisting of $1.20 cash and $.80 worth of acquiring corporation stock, or .7273 ($.80/ $1.10) shares.
We believe that the Lowest COI Method could reasonably be applied to a wide range of commercial transactions and would generally produce more appropriate COI results than the minimum shares/maximum cash rule set forth in the Proposed Regulations. Furthermore, because of the conservative assumptions with respect to the calculation of COI, we do not believe the Lowest COI Method would be subject to abuse.\(^\text{18}\)

In support of a signing date approach, the preamble to the Proposed Regulations notes that target corporation shareholders generally can be viewed as being subject to the economic fortunes of the acquiring corporation as of the signing date. This is not necessarily the case to the extent an agreement insulates target corporation shareholders from pre-closing changes in the price of acquiring corporation stock (as in Examples 4 and 5 where pre-closing declines of up to 10 percent in the value of acquiring corporation stock do not affect the aggregate value of the merger consideration to be received by target corporation shareholders). However, in cases similar to Examples 4 and 5, satisfying COI under the Lowest COI Method necessarily means that COI would be satisfied, if measured at closing, if the closing date price of acquiring corporation stock were within the range of values subject to varying consideration under the agreement, i.e., the range in which target corporation shareholders are afforded price protection. In such cases, only pre-closing declines in value of acquiring corporation stock below the low end of the range, i.e., declines with respect to which target corporation shareholders bear an economic loss similar to actual owners of target corporation stock, could result in a failure to satisfy COI (if measured at the closing date). In this respect, these cases are analogous to the simple cases illustrated in Examples 1 and 2 with respect to which there is no significant debate as to the appropriateness of a signing date approach.

c. **Variable Cash and Stock Consideration.** The Lowest COI Method could also apply where both the stock and cash consideration are subject to variation over a specified range of values of acquiring corporation stock. As above, COI would be measured using the value of the acquiring corporation stock in the range (and corresponding number of shares and amount of cash) that would yield the lowest COI percentage.

d. **Recommended Safe Harbor.** The Lowest COI Method described above could be criticized as producing unduly conservative COI results in some cases. For example, assume that an agreement includes a provision that would increase the amount of cash to be delivered to target corporation shareholders only upon the occurrence of a substantial and unexpected decline in value of acquiring corporation stock between signing and closing, and that absent such provision COI would be satisfied under the Lowest COI Method. Use of the Lowest COI Method in such a case may be considered inappropriate because it does not take into account the likelihood of the outcome under which COI would not be met.

\(^{18}\) The use of conservative assumptions in this context could be analogized to the rule in Treas. Reg. § 1.1273-1(c)(2) (requiring, in the case of a debt instrument that provides for one or more alternative payment schedules, that “qualified stated interest” be determined based on the lowest fixed rate at which qualified stated interest would be payable under any payment schedule).
Example 6 (Remote All-Cash Contingency). The facts are the same as in Example 4 (the collar arrangement), except that the agreement provides that the consideration to be exchanged for each share of target corporation stock will consist solely of $1.51 in cash if the closing date price of a share of acquiring corporation stock does not exceed $0.35. Although the likelihood that acquiring corporation shares will not exceed $0.35 per share is considered remote, the target corporation shareholders insisted on a guaranteed all-cash contingency in the event of a severe and unexpected decline in the price of acquiring corporation stock. Application of the Lowest COI Method in this case would yield a COI percentage of zero.

Because the Lowest COI Method produces conservative COI results, we believe it may best function as a safe harbor. One possibility, for example, would be to limit the applicability of the Lowest COI Method to transactions (such as the ones illustrated in Examples 4 and 5) for which it produces a COI percentage, determined as of the signing date, of at least 40 percent. In other cases (such as Example 6), COI would be measured by reference to the closing date value of acquiring corporation stock.19 Admittedly, this approach would provide less signing date certainty than would a strict application of the Lowest COI Method. However, we believe a departure from a strict signing date approach -- which would foreclose reorganization treatment where the pricing mechanism used admits of a possible non-COI outcome, regardless of the likelihood of such outcome -- may be warranted.

5. Effect of Modifications

Under the Proposed Regulations, a modification of a term of a binding agreement that relates to the amount or type of consideration to be provided to target corporation shareholders generally requires the revaluation of acquiring corporation stock as of the end of the last business day before the date of the modified agreement for purposes of computing COI.20 We believe this rule is too broad. At a minimum, we recommend that modifications providing only for the issuance of additional shares of acquiring corporation stock not require a revaluation of acquiring corporation stock. In these cases, the result of the modification is that target corporation shareholders will receive a greater interest in the acquiring corporation than they would have received without the modification. In addition, we believe the IRS and the Treasury Department should consider a general rule providing that no revaluation of acquiring corporation stock would be required for modifications that do not result in a decrease in the ratio of acquiring corporation shares to cash (as established under the original agreement).

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19 We are not proposing that the safe harbor be elective.

We also recommend that the regulations clarify that any change in the amount or type of consideration that occurs by operation of the terms of a binding agreement would not be considered a modification of such agreement.\(^\text{21}\)

6. Request for Immediate Guidance for Simple Cases

We acknowledge that some of the issues discussed above are complicated and may be subject to differing views and, therefore, may take some time to resolve. However, we also believe that there is little disagreement that the use of Signing Date Value is appropriate in the relatively straightforward transactions to which the Proposed Regulations would apply (e.g., where there is a binding acquisition agreement that provides for a fixed amount of consideration consisting solely of acquiring corporation stock and cash). Accordingly, we advocate the publication of guidance as soon as is feasible that would provide for the use of Signing Date Value to measure COI in these transactions.

\(^\text{21}\) Cf. Treas. Reg. § 1.1001-3(c)(1)(ii) (providing, in general, that an alteration of a legal right or obligation of the issuer or holder of a debt instrument that occurs by operation of the terms of the debt instrument is not a modification that could give rise to a deemed exchange).