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Pooling of Interests: Alterations of Equity Interests (47c) and Asset Dispositions (48c)

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Pooling of Interests: Alterations of Equity Interests (47c) and Asset Dispositions (48c)

OVERVIEW

As stated in paragraphs 45 and 46 of Accounting Principles Board Opinion No. 16, *Business Combinations* ("APB 16"), two underlying concepts of the pooling of interests method are that:

"The pooling of interests method of accounting is intended to present as a single interest two or more common stockholder interests which were previously independent and the combined rights and risks represented by those interests. That method shows that stockholder groups neither withdraw nor invest assets but in effect exchange voting common stock in a ratio that determines their respective interests in the combined corporation."

"Certain attributes of combining companies indicate that independent ownership interests are combined in their entirety to continue previously separate operations. Combining virtually all of existing common stock interests avoids combining only selected assets, operations, or ownership interests, any of which is more akin to disposing of and acquiring interests than to sharing risks and rights."

Alterations of Equity Interests   Paragraph 47(c) of APB 16 prohibits a combining company from altering the equity interests of its shareholders "in contemplation" of effecting the proposed business combination to be accounted for as a pooling of interests. Transactions that may constitute an alteration of equity interests that would preclude pooling of interests accounting include (but are not limited to): changes in voting rights or other rights of outstanding stock; issuance of bonus shares of stock to employees; new stock option grants; changes in the original terms of stock option or stock award plans; changes in terms of outstanding warrants, options, and convertible securities; exchanges of equity securities; unusual dividends or distributions to stockholders; and spin-offs to stockholders. By analogy, Accounting Principles Board – Accounting Interpretations Nos. 19 and 20 of APB 16 ("AIN–APB 16, #19 and #20") indicate a presumption that any alteration of equity interests within two years of initiation of a business combination or between initiation and consummation is in contemplation of effecting the business combination, and so would preclude accounting for the proposed business combination as a pooling of interests.[1] This presumption can be overcome provided there is sufficient, persuasive, and objectively verifiable evidence indicating that the alteration of equity interests was not done in contemplation of the proposed business combination. In general, the nearer the date at which the alteration of equity interests occurs to the initiation and consummation of a merger, the more sufficient, persuasive, and objectively verifiable the evidence must be. Transactions occurring between the dates of initiation and consummation require particularly strong evidence.

Asset Dispositions   Certain types of transactions included in the negotiations and terms of the business combination, either explicitly or implicitly, are contrary to the conceptual underpinnings of the pooling of interests method. For example, either the plan or the intent at consummation to dispose of a significant amount of assets within two years following consummation (except for disposals in the ordinary course of business, to eliminate duplicate facilities or pursuant to governmental orders) violates paragraph 48(c) of APB 16. Furthermore, AIN–APB 16, #22 refers to "prior or planned" disposals, which the SEC staff has generally interpreted to extend the provisions of paragraph 48(c) to preconsummation disposals as well. That is, disposals of a significant amount of assets prior to the consummation of a merger that were planned as part of the merger would preclude pooling treatment just as would dispositions of significant assets that are planned to occur within two years following consummation.

The determination of whether the presumption that a transaction involving a company's equity interests was undertaken "in contemplation" has been overcome or that a disposal of assets "was planned or intended as part of the combination" involves a careful analysis of the surrounding facts and circumstances. All available evidence, both positive and negative, must be considered in evaluating these issues.

Generally accepted auditing standards provide a framework for how to evaluate the sufficiency, persuasiveness, and verifiability of evidential matter in Statement on Auditing Standards No. 31, *Evidential Matter* (SAS 31/AU 326). For purposes of evaluating the sufficiency, persuasiveness, and verifiability of evidence needed to overcome the prohibitions in paragraphs 47(c) and 48(c) of APB 16, the same guiding principles should be applied. Those guiding principles include:

- Competent evidence is that which is both valid and relevant to the question, which is sometimes indicated by the degree of detail and analysis which supports the assertion.
- Evidence from an independent source outside the entity provides greater assurance than internally developed information.
- Data supported by objectively verifiable documentation is of greater value than data derived from subjective sources or oral representations.
- Relevant and persuasive evidence needs to demonstrate that a decision had taken place, rather than merely indicating or being suggestive of the general intentions of the entity. The entity must be able to objectively demonstrate that it is committed to the decision, independent of whether the plan of combination is carried out.
- Evidence is more persuasive when items from different sources or of a different nature are consistent and corroborate assertions.
- Evidence is more persuasive when it is prepared contemporaneously rather than after the fact.

PARAGRAPH 47(C) – ALTERATIONS OF EQUITY INTERESTS

Audit evidence which seeks to overcome the presumption in paragraph 47(c) of APB 16 by its nature may in some cases only be persuasive rather than conclusive. Accordingly, registrants and their independent accountants will need to continue to apply judgment to each situation on a

case-by-case basis. Registrants and their independent accountants should consider the cumulative effect of the various types of evidence to determine if the total of all evidence considered, both positive and negative, results in sufficient, persuasive and objectively verifiable evidence to overcome the presumption in paragraph 47(c) of APB 16.

The following examples are intended to illustrate circumstances in which sufficient, persuasive, and objectively verifiable evidence did or did not exist such that the presumption in paragraph 47(c) of APB 16 was or was not overcome. The examples presented are not intended to be an all-inclusive list of determinative factors, but rather to illustrate a general framework for evaluating the quality of evidence available for any alteration of equity interests which may be "in contemplation" of a specific pooling of interests business combination.

Example 1:

Facts: Company A announced a plan to merge with Company B on February 1, 1997 (i.e., initiation date) that was consummated on April 1, 1997. Merger discussions between the parties began on December 1, 1996 as a result of an approach by Company A. On March 1, 1997, in connection with its annual compensation cycle, Company B granted stock options to its directors, officers, and other employees. Company B's compensation cycle has been in place for more than two years (i.e., pre-March 1995), and the terms, amounts, timing, and categories/classes of recipients of the stock options granted in March 1997 are consistent with annual grants made in prior years. The amounts granted to each recipient are based upon specific performance factors, consistently applied.

Question: Does Company B's granting of stock options to its directors, officers, and other employees in March 1997, preclude the merger from being accounted for under the pooling-of-interests method?

Response: No. While the annual granting of stock options to directors, officers, and other employees in March 1997 was subsequent to the commencement of merger discussions, Company B had an established history of granting stock options every March for the past several years (i.e., more than two). Furthermore, the annual grants on March 1, 1997, were consistent with prior years' annual grants with regard to terms, amounts, and timing for each category/class of recipients. Therefore, absent any other evidence indicating Company B acted in anticipation of the merger with Company A (e.g., it was documented in previous board of directors minutes of Company B that the March 1, 1997 annual grant of stock options was to be reduced from the level of prior years due to a poor current year operating performance; however, in anticipation of the pending merger with Company A, the level of grants was restored to that of prior years) there is sufficient, persuasive, and objectively verifiable evidence to overcome the presumption that Company B's annual granting of stock options on March 1, 1997, was done in contemplation of the proposed merger with Company A.

Whether a company initiates a transaction, and whether it is an issuing or combining company in a pooling of interests transaction, is not the determinative factor in this analysis. A company that has established a historical pattern of granting stock options (e.g., terms, amounts, frequency and timing, and category/class of recipients) for a period of at least two years prior to the grant

occurring after merger discussions have commenced, absent evidence to the contrary indicating that the grant was in anticipation of the merger, would be able to overcome the presumption that the post-merger-discussions grants were done in contemplation of the proposed merger.

Example 2:

Facts: October 1, 1995 – Company C engages a third-party benefits consultant to evaluate the company's director, officer, and other employee compensation programs and make recommendations where appropriate.

December 31, 1995 – The benefits consultant issues its report to Company C's board of directors, recommending changes in Company C's compensation programs. Those recommendations include the adoption of a stock option program with 5-year cliff vesting and acceleration of vesting in the event of a change in control.[2] The consultant's report does not recommend ranges of stock option grants for each category or class of director, officer, or other employee, nor does it specify frequency or timing of option grants. The board instructs management to develop a plan to implement the consultant's recommendations.

March 31, 1996 – Company C's shareholders approve the adoption of a stock option plan developed by management that is consistent with the third-party benefits consultant report. Following the approval, the board of directors made initial grants of stock options to directors, officers, and other employees.

December 31, 1996 – Company C initiates merger discussions with Company D.

February 1, 1997 – Company D announces the signing of a merger agreement with Company C.

March 31, 1997 – Company C makes a second annual grant of stock options to its directors, officers, and other employees. This grant is consistent with the grant made in March 1996 as regards to terms, amounts, frequency and timing, and categories/classes of recipients.

April 15, 1997 – Company C and Company D consummate their merger.

Question: Does Company C's granting of stock options to its directors, officers, and other employees in March 1997, preclude the merger from being accounted for under the pooling-of-interests method?

Response: Yes. It is difficult to conclude that an established history of annually granting stock options exists (and thus overcomes the "in contemplation" presumption) when fewer than two annual grants have been made. There may be limited facts and circumstances in which other substantial compelling evidence might exist to overcome the lack of history and the "in-contemplation" presumption. However, in the above fact pattern, the benefit consultant's report lacked specificity as to ranges of option grants and did not address the frequency or timing of grants. Therefore, the report is not persuasive in overcoming the presumption that the March 1997 stock option grant is an alteration of equity interests in contemplation of the merger with Company D and, thus, violates paragraph 47(c) of APB 16.

Notwithstanding the actual annual timing of the second grant of awards under this stock option plan, there is no evidence predating the merger discussions that indicates a plan to make grants on an annual basis. Had Company C made public disclosure or otherwise documented its intention to make annual stock option grants at or about the time of its initial grants in March 1996, a different conclusion may have been reached with respect to the March 1997 grants. Further, if the March 1997 grants were not made because of the pending merger, the facts outlined above would likely be sufficient to overcome the presumption that the March 1996 grants were made in contemplation of the pending merger. However, all available evidential matter would have to be considered.

Example 3:

Facts: Assume the same facts as in Example 2 above, except that:

a) In March 1996, Company C instructs a previously engaged investment banker to begin "shopping" Company C to a list of potential merger partners (which includes Company D) that Company C and the investment banker had compiled prior to March 1996, and
b) On September 30, 1996 the investment banker and Company C evaluate a number of "expressions of interest," thus reducing the list of potential merger partners to a select few, and
c) On December 31, 1996 Company C initiates merger discussions with Company D, one of the companies on the "short list."

Question: Do these additional factors impact the answer given in the Response to Example 2 above with respect to the March 1996 grants?

Response: The added factors (a) through (c) raise a substantial amount of additional concern regarding the ability of Company C to convincingly separate the decision to grant the March 1996 stock options from the decision to pursue a merger with Company D.

Example 4:

Facts: May 15, 1996 – Company E engages an independent, third-party benefits consultant to evaluate the company's various compensation programs and to make recommendations where appropriate.

September 15, 1996 – The benefits consultant presents its report to Company E's board of directors, and recommends adoption of a stock option plan. The report also specifies recommended ranges of initial stock option grants for each category or class of director, officer, and other employee, as well as terms, amounts, and the frequency and timing of additional option grants. The board instructs management to begin developing a stock option plan consistent with the consultant's recommendations.

Prior to November 15, 1996 – Management develops and documents clearly a detailed plan as well as the initial grant recommendations which are consistent with the consultant's

recommendations, especially insofar as they relate to the specificity of the grants (e.g., specifies category/class of recipients, terms, amounts, frequency, etc.).

November 15, 1996 – The board of directors decides to recommend to the shareholders adoption of an option plan and endorses management's recommended detailed plan subject to the shareholders' approval of the adoption of a stock option plan. Proxies are mailed to shareholders seeking their approval for the adoption of the stock option plan at a shareholders meeting, which is to be held December 15, 1996.

December 1, 1996 – Company F contacts Company E regarding a potential merger of the two companies. Merger discussions commence.

December 15, 1996 – Company E's shareholders approve the adoption of a stock option plan for directors, officers, and other employees.

January 15, 1997 – Company E's board of directors, based on management's detailed plan, grants stock options to specific individuals. The initial grants are consistent with the benefit consultant's and management's recommendations that were developed prior to November 15, 1996.

February 1, 1997 – Company F announces the signing of a merger agreement with Company E.

April 15, 1997 – Company E and Company F consummate their merger.

Question: Does Company E's grant of stock options to its directors, officers, and other employees in January 1997, preclude the merger from being accounted for under the pooling of interests method?

Response: It is difficult to overcome the presumption that a grant of stock options shortly before the date the merger is initiated was not in contemplation of the business combination without an established history of granting stock options. However, all available evidential matter should be considered. In the above fact pattern this available evidential matter includes:

1. Company E received a compensation study from a third-party benefits consultant on September 15, 1996 which specified recommended ranges of annual stock option grants encompassing terms, amounts, and the frequency and timing of grants for each category or class of directors, officers, and other employees.[3]
2. The stock option plan approved by the board of directors and the detailed plan and initial grant recommendations developed by management prior to the date merger discussions commenced with Company F were consistent with the benefits consultant's recommendations.[4]
3. The minutes and related materials from the November 15, 1996 board meeting document clearly the specificity of the stock option plan, management's detailed plan and initial grant recommendations (encompassing terms, amounts, and the frequency and timing of grants for each category or class of directors, officers, and other employees), and the Board's commitment to the course of action.

4. Proxy solicitations seeking shareholder approval for the adoption of a stock option plan were distributed prior to the date Company F contacted Company E regarding a potential merger of the two companies.
5. The stock options ultimately granted were consistent with both the benefit consultant's and management's recommendations.
6. There is no evidence to indicate that Company F's contact with Company E on December 1, 1996 was initiated or solicited by Company E or by any party acting or appearing to act on Company E's behalf.

Absent any additional evidence that would contradict the above, there is sufficient, persuasive, and objectively verifiable evidence present in this example to overcome the presumption that the decision to alter the equity interests through the granting of stock options in January 1997 was made in contemplation of effecting the merger with Company F. Accordingly, even though the options were actually granted shortly before initiation of the merger, pooling of interests accounting for the merger of Company E and Company F would be appropriate, assuming all other pooling criteria had been met.

PARAGRAPH 48(C) – "SIGNIFICANT" ASSET DISPOSALS

While a plan to dispose of assets, either pre- or post-consummation, may be developed as part of a specific business combination, only plans to dispose of a "significant" amount of assets developed as part of the business combination violate paragraph 48(c) of APB 16. In general, the SEC staff has indicated the following factors should be considered in evaluating the significance of either a pre-consummation or a post-consummation asset disposition under paragraph 48(c) of APB 16:

a. The total assets to be disposed of relative to the total assets of the combining company disposing of the assets, on both a book value and a fair value basis.
b. The revenues of the operation to be disposed of relative to the revenues of the combining company.
c. The income/(loss) from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle of the operation to be disposed of relative to the income/(loss) from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle of the combining company.[5]
d. The gain or loss[6] to be recognized on the sale of the operation to be disposed of relative to the income/(loss) from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle of the combining company.

The disposal would be considered "significant" if any one of the above measurements was in excess of 10 percent. If the disposal is determined to be significant, then the plan to dispose of assets is considered to be a plan to dispose of a significant amount of assets for purposes of assessing compliance with paragraph 48(c) of APB 16.

The following examples are intended to illustrate circumstances in which sufficient, persuasive, and objectively verifiable evidence did or did not exist to support the conclusion that a plan to dispose of a "significant" amount of assets was not developed as part of the plan to merge. The examples presented are not intended to be an all-inclusive list of determinative factors, but rather to illustrate a general framework for evaluating the quality of evidence available for any asset disposition which may be considered to have been done as part of a specific pooling of interests business combination. For purposes of illustration, it is assumed that each of the asset disposals in the examples is "significant."

Example 5:

Facts: Company A announced a plan to merge with Company B on February 1, 1997 that was consummated on April 1, 1997. Merger discussions between the parties commenced on December 1, 1996 as a result of an approach by Company A. As of June 30, 1996, Company B met the criteria of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* ("SFAS 121") for the long-lived assets of Sub S to be accounted for as assets held for disposal. In addition, Company B has made the disclosures required by SFAS 121 in all consolidated financial statements prepared since June 30, 1996. Those disclosures included a statement that the disposal would be either by outright sale of Sub S or by its IPO, and that Company B was actively pursuing both plans. On February 2, 1997 Company B signed a contract to sell Sub S to an unrelated party for cash, closing the sale on March 1, 1997.

Question: Does the disposal of Sub S shortly before consummation of the merger preclude the merger from being accounted for under the pooling of interests method?

Response: No. Company B's assertion that its decision and intent to dispose of Sub S are unrelated to its planned business combination with Company A is supported by:

1. The accounting for and disclosure of Sub S's long-lived assets as held for disposal in accordance with SFAS 121 at June 30, 1996[7] , well before merger discussions commenced with Company A, and
2. Company B's active pursuit of plans to dispose of Sub S either by sale or IPO.

Therefore, absent any additional evidence to the contrary, there is sufficient, persuasive, and objectively verifiable evidence to support the conclusion that Company B's plan to dispose of Sub S was not developed in anticipation of its plans to merge with Company A. That is, there is evidence supporting the assertion that the disposition of assets would have occurred independent of whether or not the proposed business combination was consummated.

Example 6:

Facts: December 15, 1996 – Management and the board of directors of Company A develop a strategic plan to "maximize the benefit" of its mortgage-servicing division. The objective of the plan is to improve the marketability of the mortgage-servicing division in preparation for disposal of the division. The plan is clearly documented and detailed, setting forth four primary

initiatives: (1) discontinuing bulk purchases of new servicing, (2) selling all new loans originated by Company A with servicing released, (3) improving servicing portfolio delinquency rates by selling off delinquent loan servicing, and (4) improving portfolio marketability by repurchasing or terminating outstanding sub-servicing agreements. The plan, culminating in the sale of the division, is scheduled to be completed by December 1998.

Over the next year Company A actively pursues and consistently executes on the above plan, with the only exception being that they have not yet started to search actively for a buyer for the division. Company A makes no public disclosures regarding its plans or intentions for the mortgage-servicing division on the basis that such disclosures are not material.[8]

November 1997 – Company A is approached by and enters into negotiations with Company B for the sale of its mortgage-servicing division.

February 25, 1998 – Company A and Company B agree on a tentative sales price range for the division, subject to mutually agreeable terms, conditions, and due diligence, which commences shortly thereafter.

April 5, 1998 – Company C contacts Company A regarding a potential merger of the two companies. Merger discussions commence.

June 15, 1998 – Company C announces the signing of a merger agreement with Company A.

June 20, 1998 – Company A and Company B agree to terms and conditions for the sale of the mortgage-servicing division at a sales price consistent with the sales price range tentatively agreed to on February 25, 1998, close the sale, and Company A announces the sale of the division.

July 15, 1998 – Company A and Company C consummate their merger.

Question: Does the disposal of the mortgage-servicing division shortly before consummation of the merger preclude accounting for the merger under the pooling of interests method?

Response: No. However, evidence is needed to support the conclusion that the disposal was undertaken for reasons unrelated to the merger with Company C. While accounting and disclosures in accordance with either APB 30 or SFAS 121 prior to the date merger discussions commence provide persuasive evidence in that regard, other circumstances may exist in which there is sufficient, persuasive and objectively verifiable evidence to conclude that the disposal was undertaken for reasons unrelated to the merger and therefore does not violate paragraph 48(c) of APB 16.

In the above facts and circumstances, negative evidence includes the fact that Company A had made no public disclosures of its plans or intentions prior to June 1998 relative to the mortgage-servicing division. As for positive evidence, however:

1. Company A implemented a strategic plan (albeit, a plan not meeting the requirements of either APB 30 or SFAS 121 at the time) for its mortgage-servicing division in December 1996.
2. Company A actively pursued and consistently executed on that plan, with the only exception being not actively searching for a buyer.
3. Company A commenced sale discussions with the buyer, proceeding to an advanced stage on February 25, 1998, prior to Company A being contacted by Company C regarding a potential merger of the two companies.
4. The disposal was ultimately consummated at a price essentially consistent with the sales price range agreed to on February 25, 1998.
5. And finally, there is no evidence to indicate that Company C's contact with Company A was initiated or solicited by Company A or by any party acting or appearing to act on Company A's behalf.

Given these extenuating facts and circumstances, there is sufficient, persuasive, and objectively verifiable evidence to conclude that Company A's plan to dispose of its mortgage servicing division was not developed in anticipation of its merger with Company C. Accordingly, the merger of Company A and Company C would not be precluded from being accounted for as a pooling of interests.

Question: Is the answer different if closing the sale of the division occurred after the consummation of the merger?

Response: No. The conclusion is the same if the closing of the sale of the division occurred after the consummation date of the merger since the evidence supports that the plan to sell the division was not developed as part of the plan to merge with Company C.

<u>Example 7:</u>

Facts: November 30, 1995 – The board of directors of Company A meet and discuss the operating performance of Sub S because of concerns that the company's share values were being negatively impacted by Sub S's results. The board of directors instructs management to "take such steps as management deems appropriate to deal with the 'strategic issues' relating to" Sub S.

December 31, 1995 – Management discusses strategic options relative to Sub S with an investment banker, soliciting recommendations. The investment banker advises Company A management to either seek a new strategic investor/partner for Sub S or sell Sub S.

May 15, 1996 – Company A's board of directors authorizes management and the investment banker to "locate a new strategic investor/partner for Sub S." As with the November 1995 board authorization, this authorization is also vague and general in nature.

August 15, 1996 – Company A's board of directors and the investment banker discuss, but do not reach a conclusion on, expanding the investment banker's scope of services to include finding a buyer for Sub S.

December 31, 1996 – Company A consults with a second investment banker to advise it regarding strategic alternatives for Company A, including a takeover of Company A.

February 28, 1997 – Company A approaches and commences merger discussions with Company B.

April 15, 1997 – Company A's board of directors approves a plan to dispose of Sub S by sale. Management immediately begins a program to actively find a buyer for Sub S.

August 1, 1997 – Company A's board of directors authorizes management to commence negotiations with Company C for the sale of Sub S.

August 30, 1997 – Company A consummates the sale of Sub S to Company C for cash.

August 31, 1997 – Company B announces the signing of a merger agreement with Company A.

October 15, 1997 – Company A and Company B consummate their merger.

During the period from November 1995 through August 1997, none of Company A's periodic reports filed with the SEC contained any reference to its plans or intentions with regard to the disposition of all or part of Sub S.

Question: Does the disposal of Sub S shortly before consummation of the merger preclude the merger from being accounted for under the pooling of interests method?

Response: Yes. In the above fact pattern Company A initiated action to address "strategic issues" associated with its Sub S. The nature of the issues and the specific actions the company intended to take to address those issues, however, were vague and not clearly documented. Furthermore, throughout the period in question Company A neither actively pursued nor consistently executed on those initiatives. And, Company A made no disclosures in any of its periodic filings with the SEC which would indicate its plans or intentions for Sub S. It was not until well after merger discussions commenced that Company A made a clear, objectively verifiable decision with regard to its plans for Sub S.

Such facts and circumstances do not provide sufficient, persuasive, and objectively verifiable evidence that Company A either made a decision to dispose of Sub S or was committed to initiatives for the disposal of Sub S which were developed independently from and are unrelated to the proposed merger with Company B. Accordingly, there is not sufficient, persuasive, and objectively verifiable evidence to support the assertion that the plan to dispose of Sub S in April 1997 was not developed as part of Company A's plan to merge with Company B. Therefore, the combined companies would be precluded from accounting for the merger as a pooling of interests.

Example 8:

Facts: In January 1991 Company A and Company B each contributed a division into a newly formed joint venture. Both divisions were in the same line of business. Under the terms of the joint venture agreement, upon the change in control of either venturer the second venturer has the right to buy out the first venturer's interest in the joint venture for 90 percent of fair value (i.e., a call option). However, the buy out option is only exercisable in the event of a change in control. That is, if a transaction is being negotiated which would result in a change in control of the first venturer, but the transaction ultimately is not consummated, the second venturer's option to buy out the first venturer's interest does not become exercisable.

March 31, 1998 – Company C contacts Company A regarding a potential merger of the two companies. Merger discussions commence.

June 30, 1998 – Company C initiates a merger with Company A.

September 30, 1998 – Company C and Company A consummate their merger. Company B's option to buy out Company A's interest in the venture for 90 percent of fair value becomes exercisable pursuant to the joint venture agreement.

December 31, 1998 – Company B exercises its option and buys Company A's interest in the joint venture for 90 percent of fair value.

Question: Does the post-consummation disposal of Company A's interest in the joint venture with Company B preclude the merger of Company A and Company C from being accounted for under the pooling of interests method?

Response: Yes. The SEC staff's view is that significant asset dispositions triggered by the business combination are inconsistent with the "uniting of interests" concept underlying the pooling methodology. That is, but for the business combination the asset disposal would not occur. Combining companies should not be able to accomplish through contractual provisions what they would not otherwise be permitted to do in a pooling transaction, even if the contractual provision had been put in place over two years ago.

Furthermore, assuming the option is exercisable within two years of consummation of the business combination and, if exercised, would trigger a significant disposition, the SEC staff would object to accounting for the business combination as a pooling of interests, irrespective of whether the option is ultimately exercised.

The SEC staff considers the option to be a plan to dispose, and believes paragraph 48(c) of APB 16 prohibits a plan at consummation to dispose of significant assets within two years. That is, the plan to dispose at consummation rather than the subsequent execution of the plan is the paragraph 48(c) violation.

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1. There is no materiality or de minimis exception for alterations of equity interests that are deemed to be in contemplation of the proposed business combination.

2. As a reminder, the SEC staff has indicated that changes to previously granted options within two years of initiation of a merger would also need to be evaluated under the "in contemplation" presumption of paragraph 47(c) of APB 16.
3. The degree of detail and specificity as to grants is an important element to consider since a compensation study that is vague in this regard would represent a lower quality of evidence and would not be persuasive in overcoming the presumption.
4. Variances from the benefits consultant's report may call into question when the company committed to granting stock options and the specific grants to be made. Furthermore, it may undermine the persuasiveness of the compensation study as evidential matter.
5. If the combining company uses other than "income/(loss) from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle" as the basis for this test and the result is materially different from that which would have been produced if "income/(loss) from continuing operations before income taxes, extraordinary items, and cumulative effect of a change in accounting principle" had been used, the combining company should consider consulting with the SEC staff regarding the performance of this test. Furthermore, neither the numerator nor the denominator used in this test should be adjusted on a pro forma basis for restructuring charges, merger related charges or other special charges for purposes of performing this test.
6. This would be inclusive of any impairment loss recognized in connection with reclassifying an asset from "held for use" to "held for disposal" in accordance with FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.*
7. Similarly, had Sub S constituted a separate major line of business or class of customer, and met the requirements of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* ("APB 30") for classification and presentation as a discontinued operation at June 30, 1996, the same conclusion would be reached.
8. The company would need to consider the applicable disclosure requirements of FRR 36, *Management's Discussion and Analysis.*

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