King & Spalding

Public Company Advisor

Practical Insights for Public Company Counsel

May 30, 2013

King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor *to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.*

Recent M&A Developments

Recent months have seen several noteworthy developments regarding tender offers, "poison puts", reverse triangular mergers, and litigation that will impact the negotiation and execution of future M&A transactions. These developments are summarized below.

1. Tender Offers

Due largely to their timing advantages, tender offers have been used by strategic and financial buyers in numerous transactions to acquire control of public companies. It is unclear, however, whether tender offers will continue to be a popular transaction structure, at least when debt financing is required. On the one hand, recent developments in Delaware law with respect to "top-up options" should simplify tender offers and promote their use. On the other hand, a renewed focus by the U.S. Securities and Exchange Commission (the "SEC") on financing conditions in tender offers may make these structures more complex when an acquirer needs to obtain financing to complete a transaction.

a. Top-Up Options

Top-up options (which permit a purchaser to acquire newly issued shares of a target in order to consummate a "short form" merger without a shareholder vote immediately after the completion of a tender offer) have been used in most tender offers in recent years. Although top-up options have been upheld by the Delaware courts and are an effective way to shorten a transaction timeline, they have been described by practitioners as a "clunky workaround" that introduce an undue amount of complexity to address what is largely a mechanical matter.

To address these issues, the State of Delaware is expected to approve an amendment to the Delaware General Corporation Law (the "DGCL") that would permit a so called "medium form" merger with respect to merger agreements entered into on or after August 1, 2013. This new rule would permit an acquirer in a tender offer to consummate a merger without a shareholder vote if the following conditions are met:

- the target company is a public company;
- the tender offer is for "any and all" of the target's outstanding voting stock;

- after the completion of the tender offer, the acquirer owns at least the percentage of stock (and, if applicable, of each class or series of stock) that would otherwise be required to adopt the merger agreement pursuant to the DGCL and the target's charter (i.e., generally over 50%, unless the charter provision requires a supermajority);

- all target shares not acquired in the front end tender offer must be converted in the merger into the same type and amount of consideration as such shares were acquired for in the offer;

- no party to the merger agreement may be an "interested stockholder" under the DGCL at the time the target board approves the merger agreement; and

- the merger agreement expressly provides that the merger will be governed by this new section of the DGCL (i.e., the short form merger can only be used in non-hostile transactions).

b. Financing Conditions

In recent tender offers that contain a financing condition, the SEC Staff has emphasized what it views to be a longstanding Staff position regarding the satisfaction of such financing condition and the closing of the tender offer.

This SEC Staff position provides that, when an offer is not financed or when a bidder's ability to obtain financing is uncertain, a material change will occur in the information previously disclosed when the offer becomes fully financed (e.g., when financing is obtained or the financing condition is otherwise satisfied). Accordingly, once a financing condition is satisfied, the tender offer must remain open for at least five business days following this change, which is problematic for transactions that are attempting to close with the back-end merger on the same day (which is typically required by the financing for a variety of reasons).

In responses to SEC Staff comments, some purchasers have argued that this position is inapplicable to their offers by attempting to distinguish a "financing condition" (i.e., a condition relating to the ability of the purchaser to obtain committed financing) from a "funding condition" (i.e., a condition relating only to the receipt of proceeds from committed financing). The SEC Staff, however, has refused to recognize this distinction.

In response to this position, the following are two approaches acquirers can take:

- The bidder could waive the financing condition five business days in advance of the expiration of the tender offer.

- The bidder could mirror in the tender offer conditions those conditions that are set forth in the financing papers.

Both of these approaches are less than ideal for bidders, however, as they leave purchasers with the risk of having to accept shares tendered in the face of a failure of a financing source to fund its commitment. Accordingly, it remains to be seen how future tender offers that involve financing will address this issue.

2. **"**<u>Poison Put" Provisions in Debt Instruments</u>

In an opinion issued on March 8, 2013, the Delaware Court of Chancery preliminarily enjoined the board of SandRidge Energy, Inc. ("SandRidge") from resisting the consent solicitation of a hedge fund, TPG-Axon ("TPGA"), a SandRidge stockholder with a 7% stake in the company.

The brief facts of the case are as follows: in December 2012, after TPGA's proposed corporate governance reforms had been rejected by SandRidge, TPGA commenced a formal consent solicitation to declassify SandRidge's board and to replace all of its incumbent directors. In response to TPGA's consent solicitation, SandRidge commenced its own solicitation to defeat TPGA's dissident slate of directors. In its solicitation documents, SandRidge argued that replacing all of SandRidge's directors would trigger an optional redemption right with respect to SandRidge's publicly held debt securities at 101% of par. Importantly, there would be no redemption right if the SandRidge board approved TPGA's insurgent slate of directors. In effect, the SandRidge board told stockholders that if stockholders elected TPGA's board, SandRidge would suffer significant economic harm due to the proxy put, even though the SandRidge board had the power to nullify this economic harm.

The Court of Chancery enjoined the SandRidge board from impeding the consent solicitation and held that directors are under an affirmative duty to exercise their discretion to approve dissident sales and neutralize proxy puts unless the board can demonstrate that there is a "specific and substantial risk to the corporation or its creditors posed by the rival slate." In addition, in rendering its opinion the Court of Chancery expressed concern over the apparently relatively little attention that the SandRidge board had paid to the proxy put when it approved the indentures pursuant to which the notes at hand were issued.

The *SandRidge* decision has the following implications for companies:

- *Potential Evolution in Put Provisions*. While we do not expect lenders to abandon change of control puts altogether, it remains to be seen how much flexibility companies will have to negotiate put provisions that modify or eliminate certain triggers of the put (such as the change in board composition trigger in the put).

- *Valid Business Purpose Reflected in the Records*: Issuers should ensure that change of control put provisions are insisted upon by lenders, are necessary to obtain financing or other benefits to the company, and that their board is made aware of the existence and history of any such provision. As such, management and its advisors should bring any change of control put provisions to the attention of the board, and should detail for the board (and in the issuers' records) the negotiating history behind such provisions.

3. <u>Reverse Triangular Mergers</u>

In *Meso Scale v. Roche*, the Delaware Court of Chancery restored some level of certainty to the structuring of merger transactions by holding that the acquisition of a target through a reverse triangular merger does not constitute an "assignment by operation of law." This holding is noteworthy, because in a prior ruling in the *Meso Scale* case in April 2011, the Court of Chancery denied a motion to dismiss and held that the "by operation of law" language could reasonably have been intended to cover reverse mergers in which the surviving company was treated as a mere shell.

The anti-assignment provision in *Meso Scale* read as follows:

"Neither this Agreement nor any of the rights, interests or obligations under this Agreement shall be assigned, in whole or in part, by operation of law or otherwise by any of the parties without the prior written consent of the other parties..."

The *Meso Scale* court focused on the language in Section 259(a) of the DGCL and held that the statutory language does not imply a transfer by the surviving corporation of its own rights and obligations in a merger. The *Meso Scale* court also distinguished a reverse triangular merger from a forward triangular merger, where the target corporation is not the surviving entity (and would therefore transfer its rights and obligations to the surviving corporation).

The *Meso Scale* opinion has the following implications for merger transactions:

- *Importance of Transaction Structure*: The *Meso Scale* decision reinforces the importance of deal structure in merger transactions with respect to the application of non-assignment provisions. The decision should comfort acquirers that, absent an explicit change of control provision in a contract, they can avoid obtaining time consuming and costly third party consents when utilizing a reverse triangular merger under Delaware law.

- *Importance of Drafting*: When negotiating agreements, the parties should make sure they understand the intent with respect to any restriction on a change of control. If the parties intend to control what happens to the contract in connection with an acquisition of another party, they should consider including a separate change of control provision.

- *Applicable Law*: *Meso Scale* establishes the rule for reverse triangular mergers in Delaware. Though Delaware corporate jurisprudence is often persuasive in other jurisdictions, other courts could reach different results, particularly.

4. Litigation Trends

Recent years have seen a significant increase in the volume of litigation challenging public company M&A transactions. According to *Cornerstone Research*:

- *Increase in Volume of Litigation*: In 2012, shareholders challenged 93% of merger transactions valued over $100 million, and 96% of transactions valued over $500 million. As recently as 2007, only 53% of transactions valued at more than $500 million were subject to litigation.

- *Increase in Disclosure Only Settlement*. In 2012, in more than 80% of settlements the only relief for the shareholders was additional disclosures. In 2009, 75% of settlements were disclosure only settlements.

- *Decrease in Settlement Fees*: The average plaintiff attorney fee requested in disclosure only settlements in 2012 was $540,000, a decrease from $730,000 in 2009.

- *Flight to Delaware*: The proportion of merger shareholder lawsuits filed in the Delaware Court of Chancery grew in 2012. From 2002 to 2007, the trend had been for M&A litigation to move to courts in states other than Delaware.

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About King & Spalding

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