



*M&A in 2012:
Understanding The Tender Offer*

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M&A in 2012

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Introduction

Definitions of Tender Offer

- ❖ Williams Act (1968) regulates tender offers – but does not include a definition
- ❖ *Wellman v. Dickinson* (1979) - 8 Factor Test (not all factors required)
 1. An *active and widespread solicitation* of public shareholders of target company
 2. Solicitation for a *substantial percentage* of target company stock
 3. Offer to purchase shares at a *premium to prevailing market price*
 4. Terms of the offer are firm, *not negotiable*
 5. Offer contingent on a specified number of shares being tendered (and may specify a maximum number of shares to be purchased)
 6. Offer open only for a limited amount of time
 7. Target company shareholders are subjected to pressure to tender shares
 8. Public announcements precede or accompany accumulation of large amounts of shares
- ❖ SEC definition (from website):

A tender offer is a broad solicitation by a company or a third party to purchase a substantial percentage of a company's Section 12 registered equity shares or units for a limited period of time. The offer is at a fixed price, usually at a premium over the current market price, and is customarily contingent on shareholders tendering a fixed number of their shares or units.
- ❖ *Hanson Trust PLC v. SCM Corp.* (1985) - Totality of Circumstances Test

Assess whether, in light of facts and circumstances, there is a substantial risk that offerees will not have adequate information to make an informed decision

Introduction (continued)

Some Types of Tender Offers

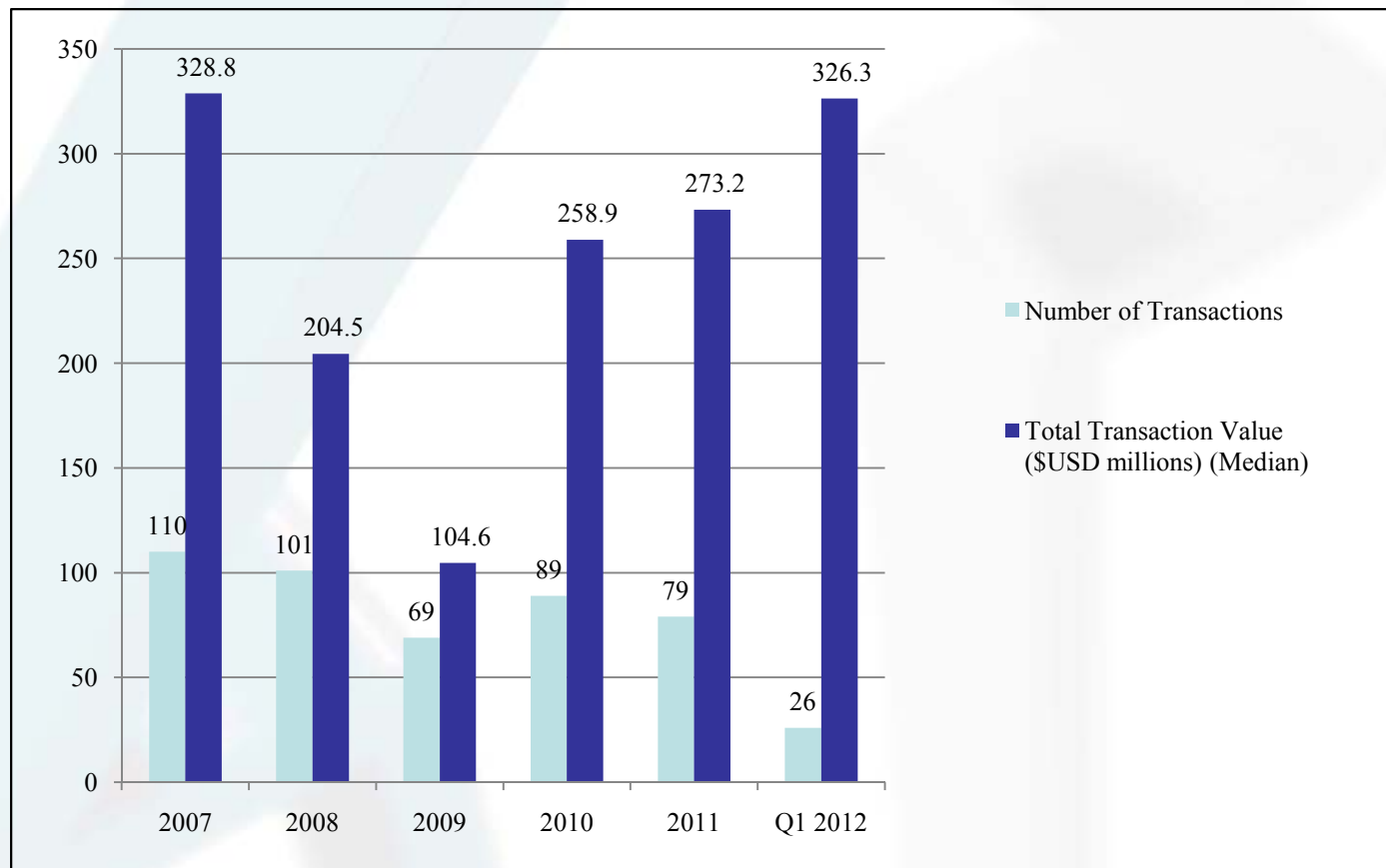
- ❖ Third Party Equity Tender Offer
 - Friendly (agreement with target company Board)
 - Hostile (no Board agreement)
- ❖ “Going Private” Transaction
 - Specialized set of rules apply, Rule 13e-3, Schedule 13E-3
 - Important: disclosure of intent to take company private, alternatives considered, fairness to unaffiliated shareholders, and details of Board approval
- ❖ Issuer Self Tender
 - Tender offer – special rules apply; most elaborate approach
 - Privately negotiated repurchases
 - Open market repurchases – Rule 10b-18 safe harbor
- ❖ Cross Border Tender Offers

Introduction (continued)

Market Activity

Tender Offers for U.S. Target Companies

Full Years 2007 to 2011 and First Quarter 2012



Introduction (continued)

Market Activity

*Tender Offers for U.S. Target Companies
Quarterly for Q1 2011 through Q1 2012*

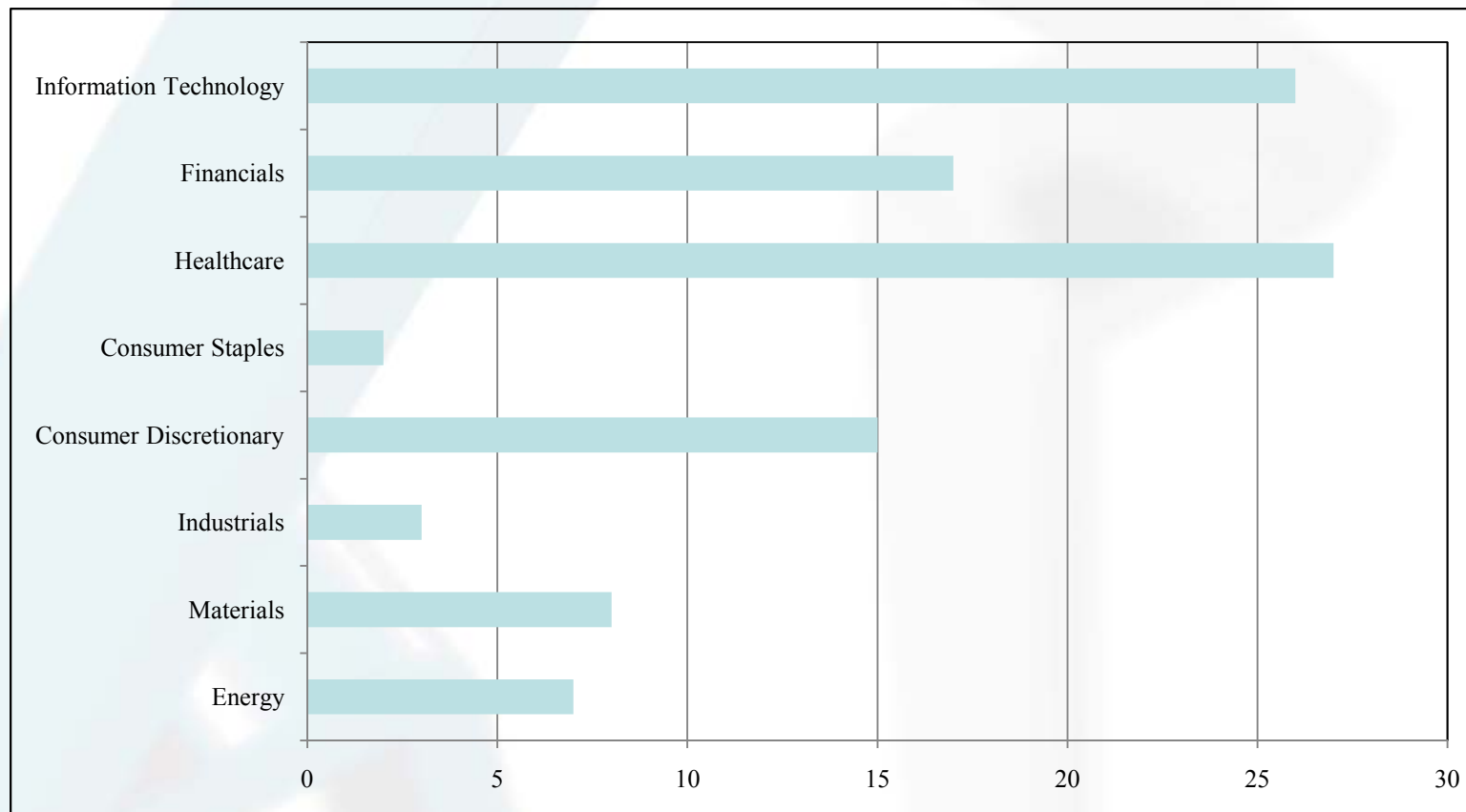


Introduction (continued)

Market Activity

Tender Offers for U.S. Target Companies

Combined 2011 and First Quarter 2012 by Industry

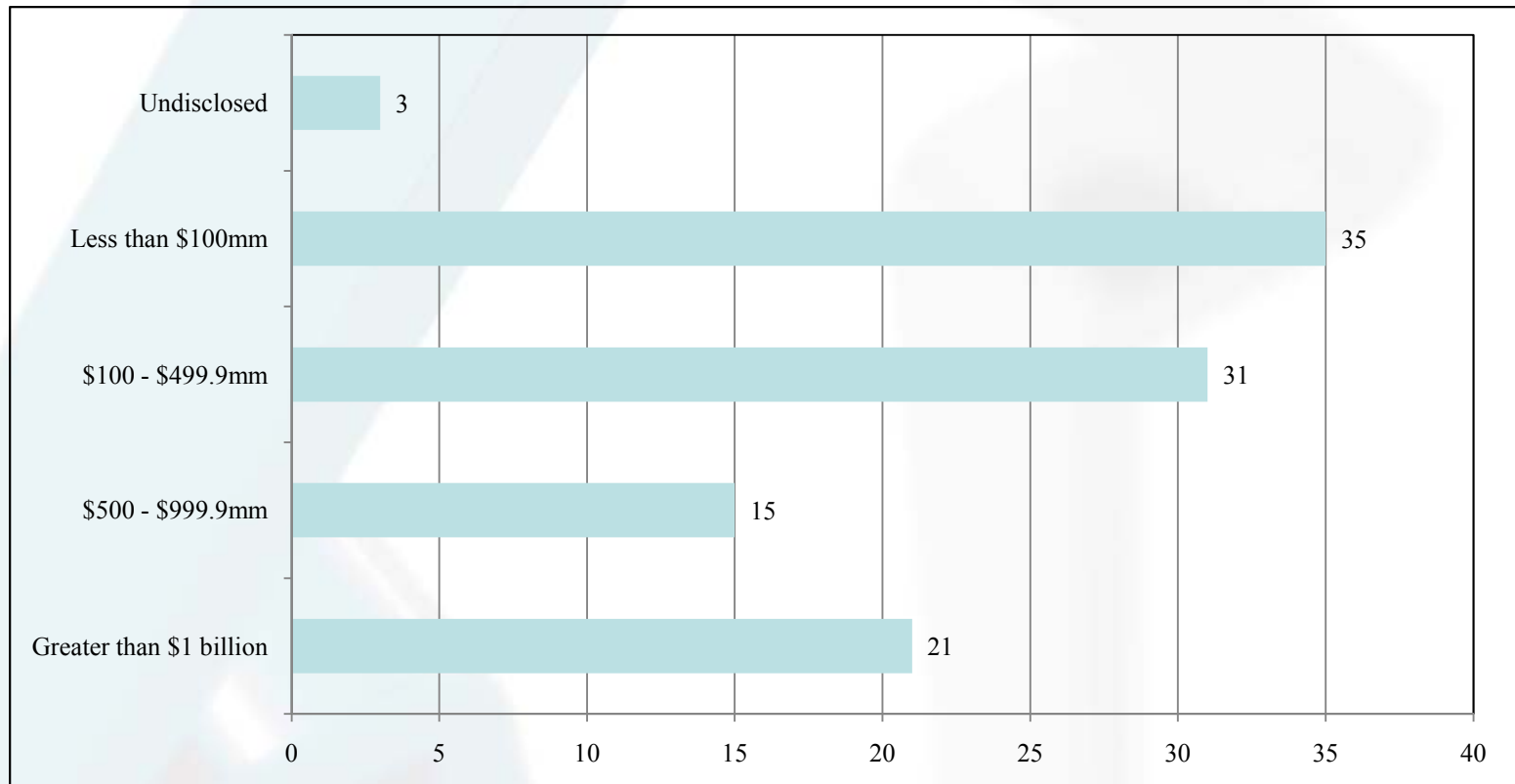


Introduction (continued)

Market Activity

Tender Offers for U.S. Target Companies

Combined 2011 and First Quarter 2012 by Deal Size



Introduction (continued)

Market Activity

*Tender Offers for Foreign Target Companies
Quarterly for Q1 2011 through Q1 2012*

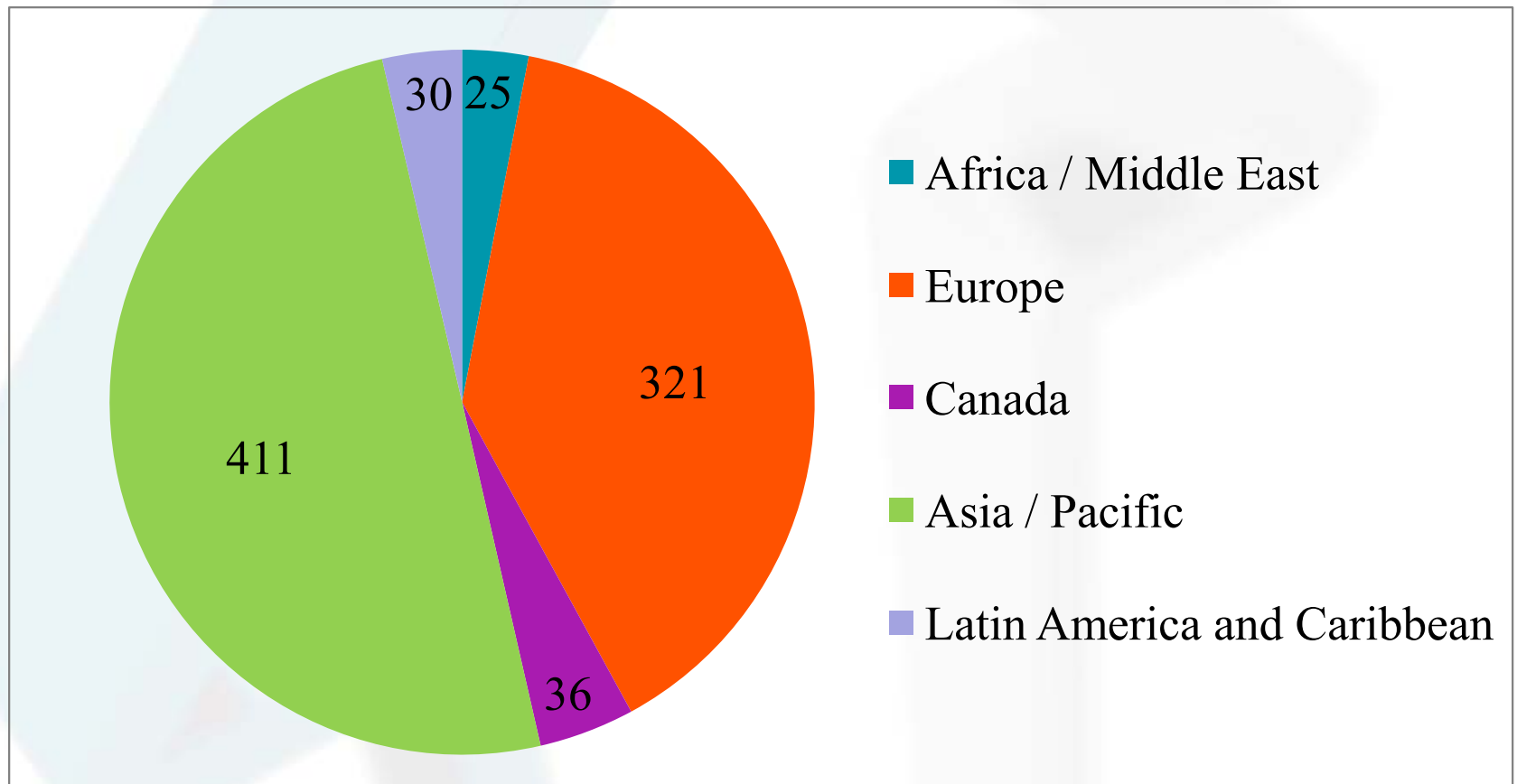


Introduction (continued)

Market Activity

Tender Offers for Foreign Target Companies

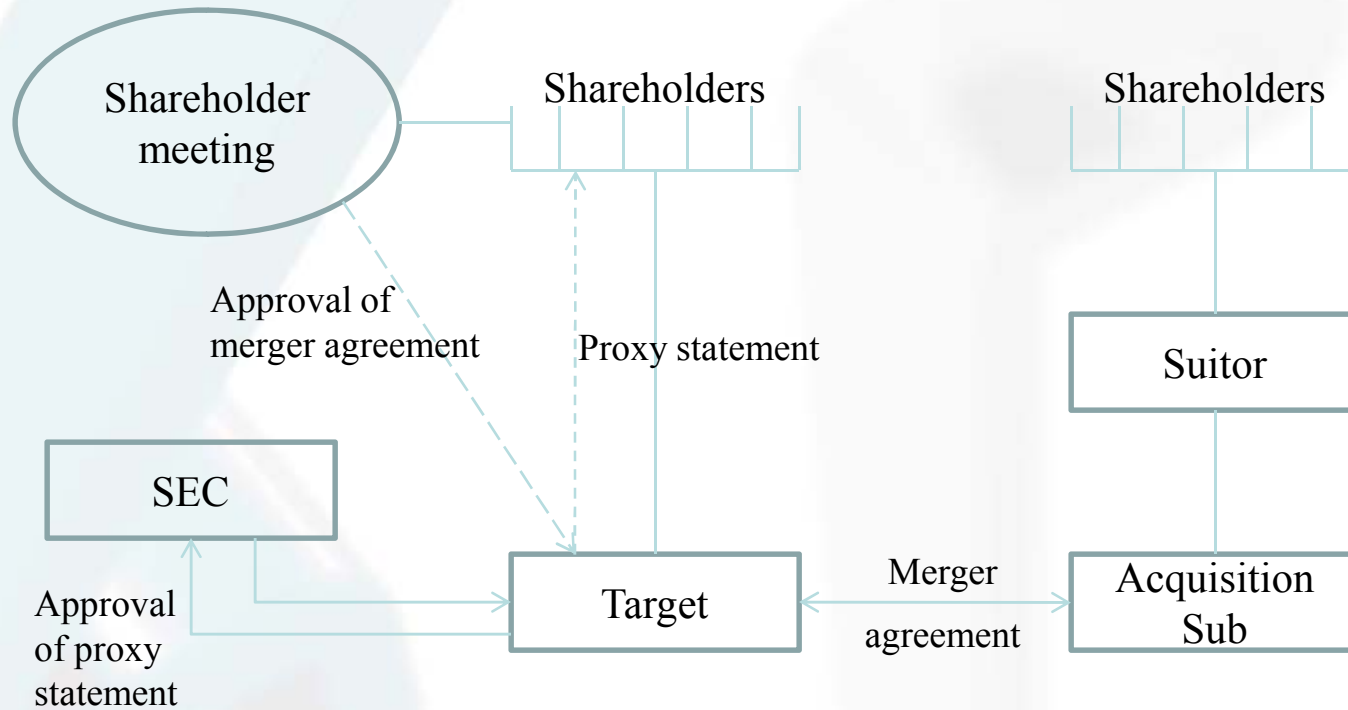
Combined 2011 and First Quarter 2012 by World Region





Transaction Structure

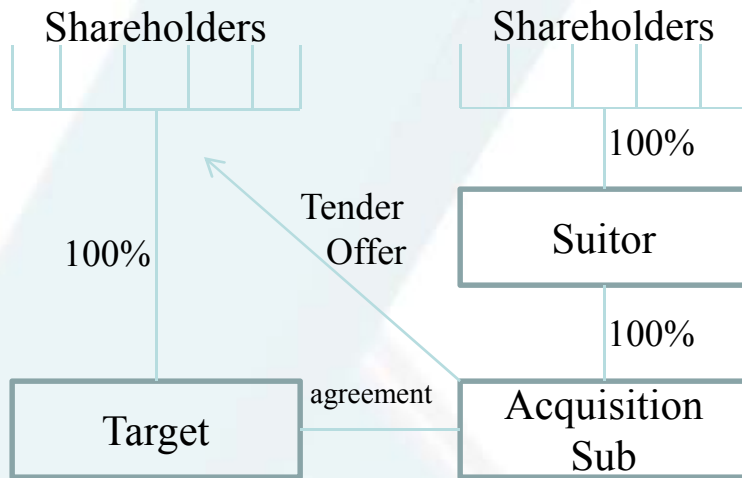
❖ 1 step Transaction



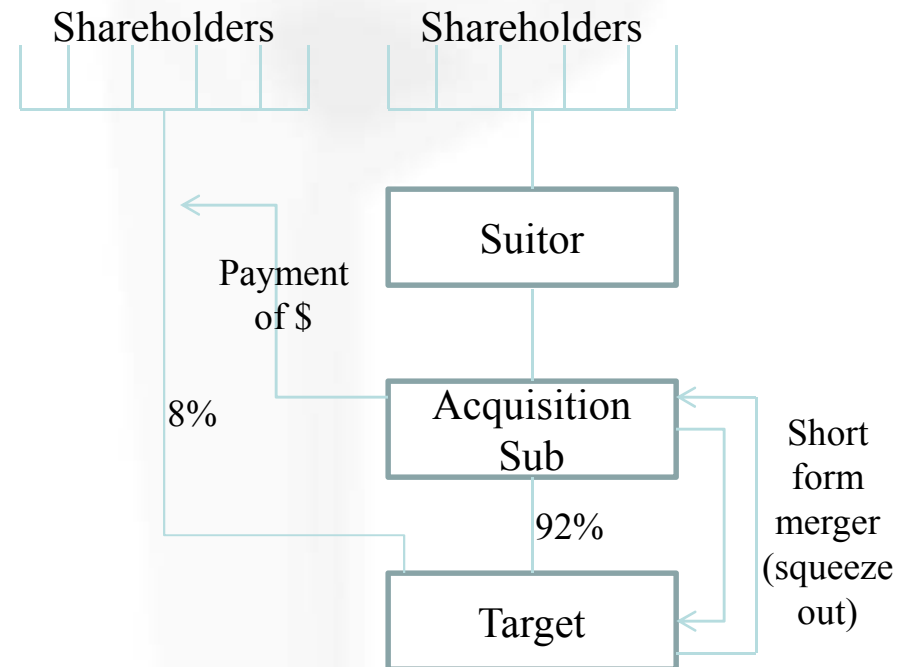
Transaction Structure (continued)

❖ 2 step Transaction

Step 1 (TO)

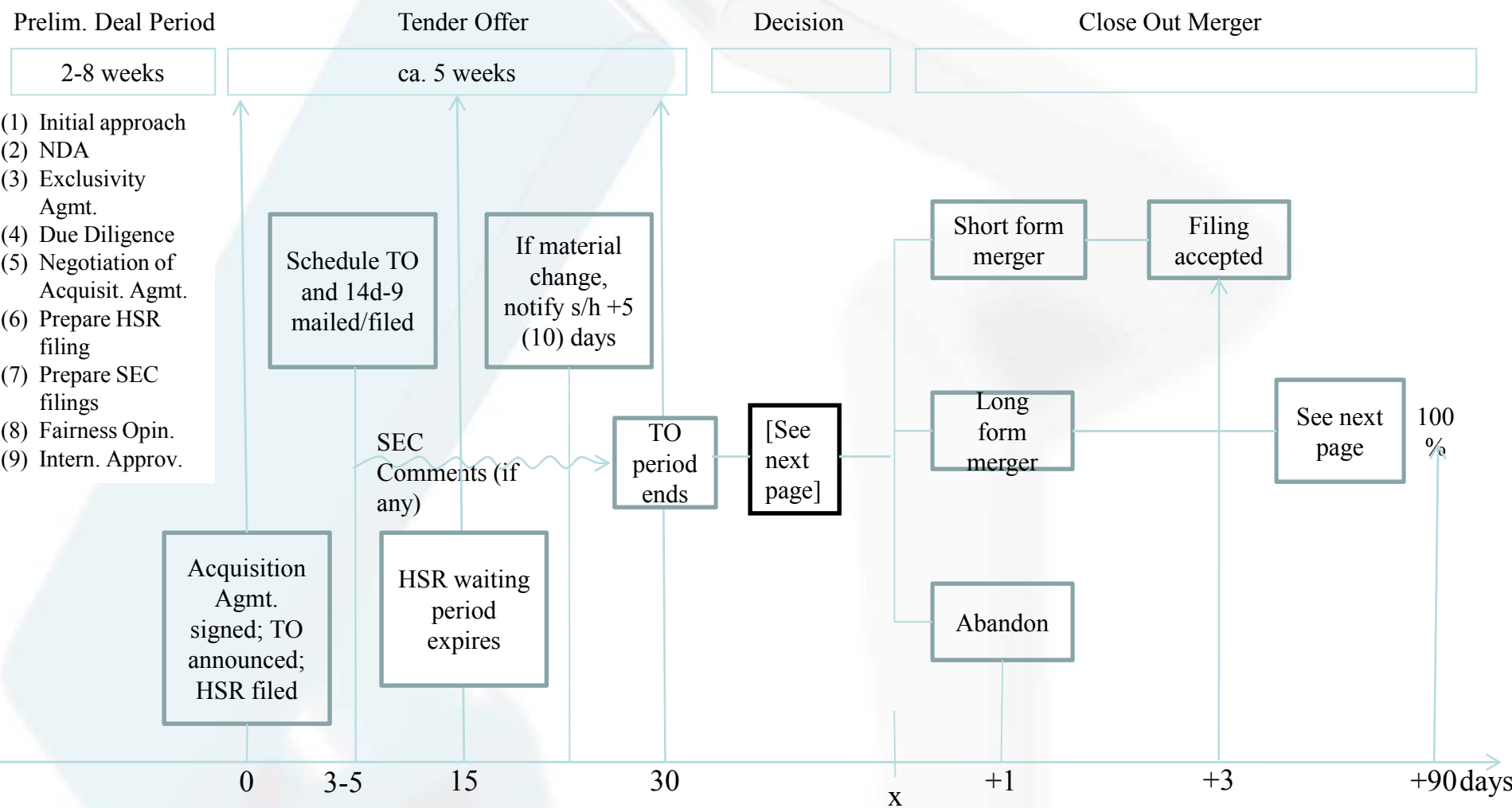


Step 2 (after TO)



Transaction Structure (continued)

Time Frame 2-Step Cash Tender Offer

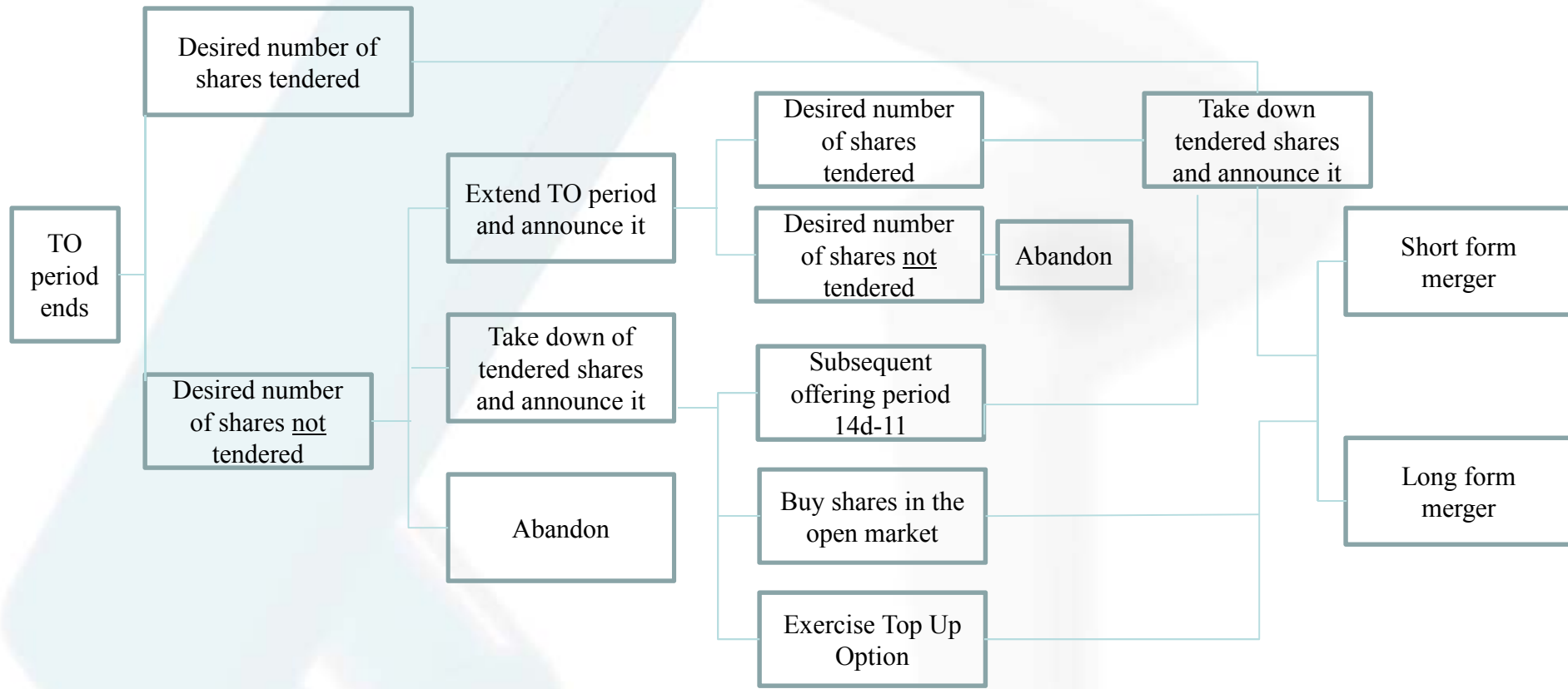


Note: Time frame for cash/stock TO: ca. 1 -2 month(s) longer, since usually form S-4 filed for securities to be exchanged and SEC must declare S-4 effective



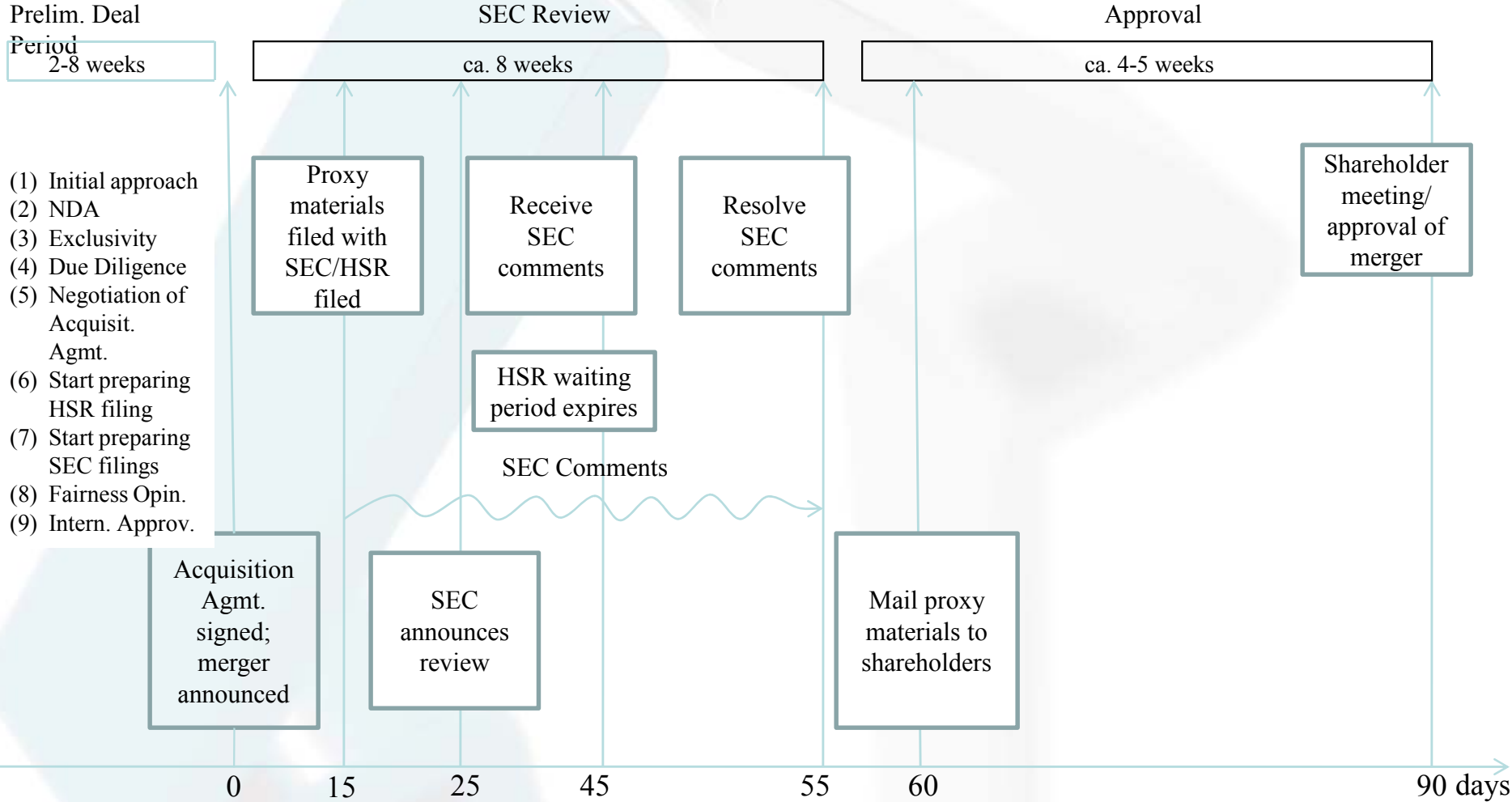
Transaction Structure (continued)

Decision Making After TO Period Ends



Transaction Structure (continued)

Time Frame Cash Merger



Time frame for cash/stock merger: ca. 1-2 month(s) longer , since usually form S-4 filed for securities to be exchanged and SEC must declare S-4 effective

Transaction Structure (continued)

Merger (1 Step) vs. Tender Offer (2 Steps): Pros/Cons

<u>Aspect</u>	<u>Tender Offer</u>	<u>Merger</u>
Government involvement • SEC • FTC/DoJ	No preclearance required; comments faster; notification only if material HSR waiting period: 15 days (if all cash)	Pre-clearance required (“clock starts again”); usually 30 days HSR waiting period: 30 days (unless terminated early)
Required Time	1-2 mos. for control; 3-5 mos. for 100%	4 – 6 mos. for 100%
Competing Bid	Lower probability	Higher probability
Complexity	Direct access to Target’s shareholder; (potentially) back end merger without s/h approval	Proxy materials/ s/h meetings often create problems
Litigation: Challenge to valuation	Yes (2011: 48 M&A class actions; 2009: 6)	Yes (2011: 48 M&A class actions; 2009: 6)
Regulatory Issues	Difficult; must extend TO period	Better; s/h approval (w/o closing) prior to regulatory approval
Share acquisition in the market	Prohibited	Allowed
Financing	In 50 – 90% range, margin rules (only ca. 50% of value), but use of capital	100% ownership accommodates easier financing

Transaction Structure (continued)

Initial Issues

❖ Due Diligence

- Access to a data room and the opportunity to submit questions regarding the Target
- Meetings with senior management of the Target
- Visits to the Target's properties and facilities
- Since the Target is a reporting company, a significant portion of the due diligence investigation can be completed by a review of the Target's filings with the SEC.

❖ Deal Parties

- Suitor typically forms acquisition sub
- Target typically represented by special committee of independent members of the Board, because of conflicts (typically senior management will maintain positions) or majority of board is not disinterested
 - ❖ Reason: May confer business judgment rule, may shift burden of proof on "entire fairness" of transaction from controlling shareholder to plaintiff, may demonstrate that transaction satisfies fairness standard
 - ❖ For details, please see our webinar of March 28, 2012

Transaction Structure (continued)

Typical Transaction Documentation: TO

- ❖ NDA (confidentiality; non-solicitation; standstill)
- ❖ Exclusivity Agreement (infrequent; not more than 15-30 days)
- ❖ Acquisition Agreement
 - Prompt commencement of TO
 - TO conditions (minimum number of shares; MAC clause)
 - Provisions on Decision Making (see slide 17), esp. subsequent periods, top up options
 - Non reliance provision (vs. express reps & warranties; fraud cut off; NDA impact)
 - Deal protection – cannot be coercive (Target’s covenant to recommend TO; conditions for termination/ break up fees and no shop/ fiduciary outs, please see our webinar of January 19, 2012; “match rights”; commitments by major s/h)
 - Consequences of Antitrust concerns
- ❖ SEC documentation
 - Schedule TO: Offer conditions
 - Schedule 14d-9: Target Board’s response to TO
- ❖ HSR Notice
- ❖ Other regulatory filings (CFIUS, etc.)



Transaction Structure (continued)

Typical Transaction Documentation: Short form merger

- ❖ In DE (State law differs): Suitor needs at least 90%
- ❖ Plan of Merger
- ❖ Resolution by parent Board
- ❖ Certificate of Merger; filed with Secretary of State (of both corporations)
- ❖ Tax Clearance from State's Tax Department for disappearing corporation
- ❖ Withdrawals/ name changes in other states
- ❖ Federal Tax: Final form 1120; form 966



Tender Offer Rules

- ❖ Schedule TO and commencement of the tender offer
- ❖ All holders rule
- ❖ Offering Period
 - Minimum period 20 business days from date TO first published or sent to Target's shareholders
 - Extensions allowed, but must be announced formally
 - Target's shareholders may withdraw shares at any time
 - Subsequent offering period: at least 3 business days
 - ❖ Initial tender closed
 - ❖ Subsequent offering period disclosed previously/ allowed in Acquisition Agreement
 - ❖ "Second" TO at same price and terms as original TO
 - ❖ Buy shares as they are tendered/ no withdrawal rights
 - ❖ Suitor must announce results and promptly close on those shares tendered



Tender Offer Rules (continued)

- ❖ Target's communication with its shareholders
 - Within 10 business days of commencement of TO must disclose its position to its shareholders (recommend to accept, recommend to reject, or no opinion or unable to form an opinion) by filing Schedule 14D-9 with SEC
 - Typically, Target Board's response is mailed to Target's shareholders together with suitor's materials (and filed with SEC)



Tender Offer Rules (continued)

- ❖ “Best Price” Rule (Rule 14d-10)
 - Equal Treatment: Consideration for securities tendered in a tender offer and paid to one shareholder must be the same as the highest consideration paid to any other shareholder
 - Exemptions
 - ❖ Employment compensation, severance, and employee benefit arrangements (= compensatory arrangements), if consideration (i) relates solely to past or future services and (ii) is not based on the number of securities held by employee. Safe harbor: Compensatory arrangements approved by independent directors of Target or Compensation Committee of suitor (Rule 14d-10(d)(2))

Major Legal Issues

Section 13/Schedule 13D

- §13 Requirement to report beneficial ownership (see below) of more than 5% of any registered class of securities; typically on Schedule 13D (Schedule 13G only if no intent to change or influence Target's control)
- Timing (1) 10 days after crossing threshold of 5%; and (2) promptly, each time a "material" change occurs, such as 1% ownership change up or down
- Information Schedule 13D must disclose (1) purpose of purchase, (2) plans for additional purchasers, a significant corporate transaction, a change in the Board of Directors, etc., and (3) arrangements with others regarding securities of Target (so called "Groups")
- Market 13D (and 13G) filings are closely watched by the market
- Beneficial Ownership (1) Actual ownership, (2) arrangement to vote, or direct the vote of, securities, (3) arrangement to sell or direct the sale of securities, and (4) right to acquire beneficial ownership within 60 days
- Groups Two or more persons agree to act together to purchase, sell or vote securities. Each Member of a group is deemed to hold all securities of the group and, thus, must report. Example: Parent owns 3.6%, Sub 1 owns 0.85% and Sub 2 owns 0.75%; each entity must report ownership of 5.2%!!

Major Legal Issues

Top Up Options

- What is it?
 - ❖ Stock option granted by Target to Suitor to allow Suitor to increase its stock ownership to 90% so as to effect a short-form merger
 - ❖ Target required to issue new shares which are typically cancelled in subsequent merger
 - ❖ Suitor typically pays for these new shares with a note which is subsequently cancelled
 - ❖ Example: Suitor acquires 60 of Target's 100 shares in Tender Offer; then buys 300 shares to get to 90% under Top Up Option ($360/400 = 90\%$); example shows that Top Up Option can be used to smooth out small deviations only.

Major Legal Issues (continued)

Top Up Options (continued)

- ❖ Potential stumbling blocks
 - ❖ Confirming that target company has sufficient authorized shares available
 - ❖ NYSE and NASDAQ require shareholder approval if company issues more than 20% of new shares under certain circumstances; thus, top up option cannot remedy everything
 - ❖ Target company Board's duty to determine proper consideration to be paid for top up shares

Major Legal Issues (continued)

Appraisal Rights

- ❖ Definition: Shareholder who disagrees with merger consideration and does not agree with merger (or is not asked, for instance, in a short form merger) can petition courts for a determination of the proper consideration § 262 DGCL
 Exceptions:
 - (1) No appraisal rights if Target’s shares are listed on a National Security Exchange or held by more than 2,000 shareholders (“publicly traded corporation”) except if merger consideration is something other than:
 - shares of surviving corporation
 - shares of any other publicly traded corporation
 - cash for fractional shares
 - any combination of above
 - (2) No appraisal rights for shares of surviving corporation
- ❖ Procedural Requirements
 - ❖ Plaintiff held shares from demand to effective date of merger
 - ❖ Plaintiff voted against merger or abstained
 - ❖ Plaintiff made written demand for appraisal prior to merger vote or, in case of short form merger, within 20 days of mailing information notice
 - ❖ Plaintiff filed petition in Chancery Court within 120 days of effective date of merger

Major Legal Issues (continued)

Appraisal Rights (continued)

- ❖ Appraisal by DE Courts
 - Court must determine “fair value” (§262(h) GCL) as a going concern and is not bound by any extrinsic statistics, such as merger price or elements of fairness opinion, see Golden Telecom, Inc. v. Global GT LP, 11 A.3rd 214 (Del. Ch. 2010)
 - “Fair value” determination: Any reasonable valuation methodology allowed, including any projections into the future, as long as not speculative
 - ❖ DE courts have bias towards Discounted Cash Flow analysis (“DCF”), believed to be a business’ “intrinsic value”. Ca. 2/3 of all appraisal right cases are based on DCF (alone or with transaction or comparables; see below). Difficulty in applying this methodology highlighted by Taylor v. American Specialty Retailing Group, Inc., 2003 Del. CH. LEXIS 75 (July 25, 2003): Plaintiff concluded a value of \$14,667 per share, defendant of \$2,200 per share, and court of \$9,079 per share.
 - ❖ DCF is calculated as follows:
 - Target’s future free cash flow for a specific period as projected by (ideally) management (ideally) prior to merger; plus
 - Target’s terminal value, i.e. cash flow post projected period determined by calculating constant perpetuity growth (preferred by courts) or by using multiples from comparable transactions/ companies; and

Major Legal Issues (continued)

Appraisal Rights (continued)

- discounted to present value, using a rate based on the Target's weighted average cost of capital (both equity and debt), a fairly sophisticated calculation. Courts prefer the use of existing capital rather than target capital structure. Ca. 4/5 of all cases come out at a discount rate of between 10% and 20%.
- ❖ Other recognized valuation methodologies (usually carefully scrutinized by DE courts)
 - Transaction Approach: based on transaction multiples at which similarly situated companies have been acquired (typically higher since it accounts for control premium) in the same relevant time period (Highfields Cap., Ltd. v. AXA Financial, Inc. 939 A.2d 34 (Del. Ch. 2007))
 - Comparable Company Approach: based on earnings multiple of public companies; DE courts recognize a built in minority discount due to minority position of most s/h in public companies which requires a counteracting premium (premiums range widely and have historically been between ca. 12 – 42%).
- ❖ Other indications of value, such as LBO analysis, net asset value, or break up analysis are rarely used

Major Legal Issues (continued)

Appraisal Rights (continued)

- ❖ Sample recent DE cases
 - ❖ Facts/assumptions used in valuation must be timely (In re Sunbelt Beverage Shareholder Litig., 2010 Del. Ch. LEXIS 1 (Jan 5, 2010))
 - ❖ Board must fully understand financial analysis and properly disclose in proxy statements (Maric Capital Master Fund, Ltd. v. Plato Learning, Inc., 11 A.3rd 1175 (Del. Ch. 2010))
 - ❖ Financial analysis must be updated; here: results better than projected and rising stock price (In re Southern Peru Copper Corp. Shareholder Derivative Litig, 2011 Del. CH. LEXIS 160 (Oct. 14, 2011))
- ❖ Appraisal right cases are rare; according to a recent study, only 49 cases filed during QI/ 1985 – QII/ 2011 period, i.e. 1.8 cases per year. Reasons:
 - 1) Approval by Target’s Board required which has to discharge its fiduciary duties; must act “in the best interest” of shareholders, or even “entirely fair” (i.e. fair process, fair price).
 - 2) Dissenter does not get paid until dispute resolved and during dispute dissenter does not receive dividends and cannot vote shares.
 - 3) Dissenter must pay her counsel, expert witness, etc. initially and often ultimately since cost sharing/allocation in court’s discretion and allocation usually only as between dissenters
 - 4) Dissenter has no right to receive at least merger consideration; but only 9 out of the 49 cases cited above resulted in appraisals at or below merger price
 - 5) Courts usually do not grant interest on award, even though the statute specifically allows interest and specifies a rate of 5% above Federal discount rate

Major Legal Issues (continued)

Corporate Approvals

- ❖ Typical TO transaction: Standard = business judgment rule (duty of care, i.e. information + appropriate deliberation, and duty of loyalty, i.e. no self-dealing)
- ❖ Going Private transactions or majority of directors are conflicted or transaction with a controlling shareholder: Standard = entire fairness (fair dealing, fair price)

Cross Border Tender Offers

❖ **Definition** of a cross border TO

- Outside of the U.S.: Laws apply to any corporation formed or listed in that country
- In the U.S.: Laws apply to any corporation (incl. FPI) that has U.S. s/h
 - ❖ Definition of foreign private issuer (“FPI”): organized under foreign law, unless (i) more than 50% of securities held by U.S. residents, and (ii) majority of officers + directors are U.S. residents, more than 50% of assets are located in the U.S., or business is run from within the U.S.
- Goal is protection of U.S. investors
- Compliance with U.S. law often onerous and U.S. s/h often excluded (so called exclusionary offers); rules are designed to entice offerors to include U.S. s/h

❖ **Determination** of number of U.S. Persons

❖ **Tier System**

- **Tier I:** 10% or less of Target’s shares held by U.S. Persons (exempted)
- **Tier II:** More than 10% but less than 40% of Target’s shares held by U.S. Persons (partially exempted)
- **Tier III:** More than 40% of Target’s shares held by U.S. Persons (not exempted)

Cross Border Tender Offers (continued)

❖ **Determination of U.S. shareholders**

- The term “U.S. Person” is defined in Reg. S
- Relevant date for determination: Any day 60 (special circumstances: up to 120) days prior to or 30 days after announcement of TO
- Look through “street names” and determine beneficial owner (but only street names in the U.S., in the country of formation of the Target or Suitor, and country where majority of shares are being traded)
- Must review website of target, SEC filings and contact street names; if no cooperation, investor assumed to be resident where street name is located
- In special cases (no s/h list available, all stock is held in bearer shares, data protection laws prohibit disclosure, hostile TO): Use information disclosed by Target to its home country authorities, Suitor’s own information, regardless of how obtained, and assume that percentage of U.S. shareholders equals U.S. average trading volume over average worldwide (at least 55% of trading volume must take place in one or two foreign jurisdictions) trading volume, both during the 12 month period ending on any day within the 60 day period prior to announcement of TO
- Suitor’s own knowledge (incl. any “readily” available, such as public, information)
- Options, warrants, convertibles, etc. are not counted, unless TO includes them

Cross Border Tender Offers (continued)

- ❖ **Tier I:** TO is exempted from U.S. Securities Laws, incl. “going private” requirements (but: 10b-5 liability applies), if:
 - U.S. shareholders may participate in TO like foreign shareholders
 - ❖ Allowed exception: Suitor may offer cash to U.S. shareholders, even if cash and securities or only securities are offered to foreign shareholders (but value of both offers must be the same). Special rules if debt instruments or SEC registered securities are used (rare).
 - Suitor makes tender materials required under securities laws of Target’s or Suitor’s home country available to U.S. shareholders in English (typically by e-mail or on Suitor’s homepage)
 - Typically, Suitor need not file with the SEC
 - Target can contact its shareholders without complying with U.S. securities laws
 - Suitor may purchase shares outside of the TO, provided (i) tender documentation for the U.S. shareholders references that possibility, (ii) the details of these ex-tender offer purchases will be made public as required under home country law, and (iii) all purchases must abide by home country law.

Cross Border Tender Offers (continued)

- ❖ **Tier II:** Tender Offer is subject to U.S. Securities Laws with certain exemptions (partial listing only):
 - Offer to U.S. shareholders can differ from offer to shareholders abroad (as long as both shareholder groups receive the same value for their shares); makes compliance with foreign securities laws easier
 - Offer to non U.S. shareholders (which might differ from U.S. rules) can be directed at U.S. shareholders if foreign law prohibits the exclusion of foreign shareholders and risks are adequately and completely disclosed
 - Offeror + financial adviser allowed to make purchases outside, but during TO (such as in the open market), if permissible under home country law (certain conditions apply)
 - During subsequent offering periods: (1) Offeror may delay up to 20 days payment for shares tendered by non U.S. shareholders; (2) Offer can provide for Offeror's discretion in determining the percentage of cash and securities in the purchase price ("mix and match"); and (3) Offeror may pay interest on tendered securities
 - Offeror may prohibit withdrawal of tendered shares in case of waiver or reduction of minimum acceptance condition (certain conditions and restrictions apply)
 - Offeror may terminate the initial offering period in Offeror's discretion as long as period was open at least 20 days (certain conditions apply)

Cross Border Tender Offers (continued)

- ❖ **Tier II:** Filing with SEC
 - Completed form CB
 - English translation of TO and other relevant materials (press releases, etc.)
 - In case of non U.S. offeror: Appointment of U.S. agent for service of process
- ❖ **Tier I and II:** Special rules if Target's securities are registered with SEC
- ❖ **Exchange Offers:** Target's s/h receive securities of offeror or its affiliated companies - 3 tier system applies as well



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- ❖ Please click [here](#) for more information on the January 19th M&A in 2012: Update on Fiduciary Outs in M&A Transactions
- ❖ Please click [here](#) for more information on the March 28th M&A in 2012: Use of Special Committees in M&A Transactions

For questions which could not be answered today, please write to us



Questions



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