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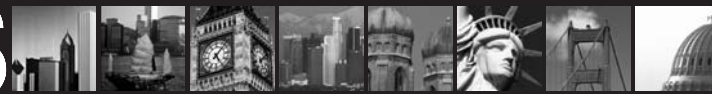
M&A NOTES



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Topps Decision: Delaware Chancery Court Invalidates Standstill Agreement Preventing Competing Bidder From Making a Topping Tender Offer and Full Disclosure of Relevant Facts Surrounding Merger

In the recent case of In re: The Topps Company Shareholders Litigation,[1] the Delaware Chancery Court, in a decision by Vice Chancellor Strine, held that the board of directors of The Topps Company most likely breached its fiduciary duties by misusing a standstill agreement with The Upper Deck Company to prevent it from making a non-coercive tender offer for Topps' outstanding shares at a higher price than that provided for in a merger agreement between Topps and an entity affiliated with Michael Eisner. Consequently, the Court issued an injunction enjoining the Topps' shareholder vote on the pending merger until such time as Upper Deck is released from the standstill agreement to permit it to make a tender offer for Topps and to publicly comment on its negotiations with Topps. The Court also enjoined the Topps' shareholder vote on the merger until Topps discloses several material facts not contained in the merger proxy, including facts regarding assurances given by Eisner that existing management would be retained after the merger. For the reasons discussed below, the decision is significant for all M&A practitioners.

The Facts

Background

The Topps Company ("Topps" or the "Company") is a Delaware public company that makes baseball cards and bubble gum. The chairman and CEO of Topps ("Shorin") is the son of the one of the founders of the Company and owns approximately 7% of the outstanding equity of the Company, and the president and COO is Shorin's son-in-law. Topps' primary competitor in the baseball card business is The Upper Deck Company ("Upper Deck"). Since 1999, Upper Deck had repeatedly indicated to the Company its interest in a possible business combination between the two companies, but negotiations apparently never progressed beyond a preliminary stage.

Topps' business was in steady decline during the last 10 years, and its profitability had suffered. In 2004, the Company began a strategic review of its business and in 2005, in response to a threatened proxy contest by a hedge fund, it undertook an auction of its bubble gum business which was ultimately unsuccessful. Following the failed auction of the bubble gum business, the same hedge fund that had

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[1] C.A. No. 2786-VCS, consolidated with *The Upper Deck Company and Northwood Investors LLC v. The Topps Company, Inc., et. al*, C.A. No. 2998-VCS (Del. Ch. Ct., June 14, 2007).

threatened a proxy contest in 2005 commenced a proxy contest to elect three directors to Topps' nine person Board of Directors (the "Board"). The hedge fund agreed to terminate its proxy solicitation in exchange for an agreement pursuant to which the Board was expanded from nine to ten members and three designees of the hedge fund (the "Dissident Directors") were appointed to the Board.

Eisner Negotiations

In June 2006, during the proxy contest, Michael Eisner, the former CEO of the Walt Disney Company ("Eisner"), approached Shorin about a possible going private transaction. The Board postponed discussions with Eisner until the proxy contest was resolved and an "ad hoc" committee (the "Ad Hoc Committee") composed of two of the directors on the Board prior to the appointment of the Dissident Directors (the "Incumbent Directors") and two Dissident Directors was established. In the Fall of 2006, the Ad Hoc Committee, on behalf of the Board, and Eisner commenced negotiations regarding a going private transaction. In late December 2006, Eisner submitted a formal indication of interest to acquire Topps for \$9.24 per share. The two Dissident Directors on the Ad Hoc Committee recommended that the Board reject Eisner's offer and undertake a public auction of the Company. The Board rejected the idea of a public auction of the Company, in part because of the failed auction of the bubble gum business the prior year, and authorized the Ad Hoc Committee to continue discussions with Eisner.

In January 2007, Eisner indicated that he was willing to increase his offer for Topps to \$9.75 per share if the Company were willing to enter into exclusive negotiations with him for a period of 30 days. The Ad Hoc Committee deadlocked 2-2 as to whether to enter exclusive negotiations with Eisner on these terms (with the Incumbent Directors on the committee voting to enter into negotiations and the Dissident Directors voting against doing so), so the matter was referred to the full Board, which voted 7-3 in favor of entering into negotiations, with the Dissident Directors dissenting. Due to the Board's concern that the Ad Hoc Committee was likely to deadlock on major issues regarding the Eisner proposal going forward, the Board dissolved the committee. In late January, the Company and Eisner entered into a letter of intent providing for an exclusive negotiating period through March 2, 2007. On March 5, after the Board received a fairness opinion from its financial advisor that the consideration being offered by Eisner (\$9.75 per share) was fair to the Topps shareholders from a financial point of view, the Board approved the merger agreement (the "Merger Agreement") by a vote of 7-3, with the Dissident Directors again dissenting.[2]

Eisner Merger Agreement

The Merger Agreement contains the following relevant provisions:

(1) A 40 day "go shop" period during which Topps could seek superior proposals. After the end of the go shop period, Topps can continue negotiations with any party that, during the go shop period, submitted a superior proposal or a proposal that "may reasonably be expected to result in" a superior proposal (an "Excluded Party");

(2) A standard no solicitation/fiduciary out provision effective after the end of the go shop period;

(3) A right on behalf of Eisner to match a superior proposal;

(4) A standard termination provision that permits Topps to terminate the Merger Agreement to accept a superior proposal;

(5) A two-tiered termination fee pursuant to which Topps is obligated to pay Eisner (i) \$8 million (plus up to \$3.5 million of expense reimbursement) if the Company terminates the Merger Agreement to accept a superior proposal during the go shop period or (ii) \$12 million (plus up to \$4.5 million of expense reimbursement) if the Company terminates the Merger Agreement to accept a superior proposal after the end of the go shop period. The amounts, inclusive of the maximum amount of expense reimbursement, represent approximately 3.0% and 4.3% of the total deal value, respectively;

[2] Eisner entered into the Merger Agreement, and proposed to provide the equity for the transaction, through an investment fund and together with a private equity firm. References herein to "Eisner" shall include these entities unless the reference is clearly intended to refer to Mr. Eisner himself.

(6) A $12 million reverse termination fee if Eisner materially breaches the Merger Agreement and fails to close the transaction;

(7) A provision that Topps has to enforce, and cannot waive the terms of, any standstill agreement with any other party unless the failure to do so would be inconsistent with the Board's fiduciary duties to Topps' shareholders under applicable law; and

(8) A "hell or high water" regulatory approval covenant that requires Eisner to take any actions, including divesting itself of assets, to obtain antitrust or other regulatory approval of the transaction.

The Merger Agreement did not contain a financing or due diligence closing condition.

Upper Deck Bid

In light of the dysfunctional nature of the Ad Hoc Committee in considering the Eisner bid, the Board established an executive committee (the "Executive Committee") consisting of five Incumbent Directors to consider offers that might be received during the go shop period but reserved for the full Board's determination whether a proposal received during the period constituted a superior proposal or could reasonably be expected to result in one. At the commencement of the go shop period, Topps' financial advisor approached over 100 parties regarding their possible interest in acquiring the Company. Five of those parties, including Upper Deck, expressed an interest in a transaction with Topps and began a due diligence review of the Company. Of these five bidders, only Upper Deck made a serious offer to acquire Topps.

During the go shop period, Topps insisted that Upper Deck sign a confidentiality and standstill agreement (the "Standstill Agreement") which, among other things, prohibited Upper Deck from: (1) disclosing the fact that it had been provided with confidential information regarding Topps or had executed the Standstill Agreement; (2) making any public disclosure with respect to the proposed transaction; and (3) making any offer to acquire Topps common stock, whether by means of open market purchases, a tender offer or otherwise, for a period of two years without Topps' consent.

Two days before the end of the go shop period, Upper Deck submitted to the Board a non-binding indication of interest to acquire Topps for $10.75 per share. Upper Deck provided Topps with a merger agreement based on the Merger Agreement but containing the following changes: (1) deletion of all representations and warranties regarding Upper Deck's ability to finance the transaction; (2) deletion of the "hell or high water" regulatory approval covenant and the insertion of a provision that made it clear that Upper Deck would not need to divest assets to obtain regulatory approval of the transaction; and (3) addition of a "due diligence out" that conditioned the closing of the transaction on Upper Deck's satisfaction with its due diligence review of Topps' business. Topps asked Upper Deck for information regarding its ability to finance the transaction, presumably because Upper Deck is not a public company (and thus its financial statements are not public) and because it had deleted the financing representation from the proposed merger agreement. Upper Deck initially resisted Topps' request for financial information.

Two days after the go shop period expired, the Board met to consider Upper Deck's bid and to determine whether Upper Deck should be deemed to be an Excluded Party, which would have permitted Topps to continue negotiations with Upper Deck under the go shop provision. The Board determined, on a vote of 5-1 (with several directors absent and one Dissident Director dissenting), to not treat Upper Deck as an Excluded Party, purportedly for three reasons: (1) Upper Deck's failure to provide evidence of its ability to finance the transaction; (2) the antitrust risk presented by an Upper Deck/Topps combination and Upper Deck's refusal to accept this risk; and (3) the size ($12 million) of the reverse termination fee (which also served as a cap on Upper Deck's total liability to Topps in connection with the transaction), which the Board deemed to be small relative to the risk of the deal not closing.

Approximately a month later, Upper Deck made another unsolicited offer to acquire Topps for $10.75 per share. This offer was not subject to a financing contingency, included a strong "hell or high water" regulatory approval covenant and was accompanied by a letter from a substantial financial institution (the "Upper Deck Financing Source") stating that it was "highly confident" that it could finance the transaction. However, Upper Deck's offer continued to limit Topps' remedy for a failure to close the transaction to a $12 million reverse termination fee. The Board determined not to treat Upper Deck's second offer as a superior proposal under the Merger Agreement and thus, under the terms of the Merger Agreement, it could not pursue the offer. Upper Deck ultimately asked Topps to be released of its obligations under the Standstill Agreement so it could comment on its negotiations with Topps and make a tender offer for shares of Topps common stock, but Topps declined the request.

Thereafter Upper Deck and some shareholders of Topps filed suit against the Company, the Incumbent Directors and Eisner, seeking a preliminary injunction to: (1) stop the shareholder vote on the transaction with Eisner; (2) require Topps to correct material misstatements contained in the merger proxy; and (3) prevent Topps from using the Standstill Agreement to preclude Upper Deck from making a tender offer for the Company and disclosing its version of its negotiations with Topps.

The Decision

On June 14, 2007, the Delaware Chancery Court issued a preliminary injunction enjoining the shareholder vote on the merger between Topps and Eisner until: (1) Topps discloses several material facts not contained in the merger proxy, including facts regarding Eisner's assurances that he would retain existing management after the merger; and (2) Upper Deck is released from the Standstill Agreement for purposes of (a) publicly commenting on its negotiations with Topps and (b) making a non-coercive tender offer for shares of Topps common stock on terms no less favorable than those contained in its offer to the Board. In reaching this decision, the Court concluded that Upper Deck and the shareholder plaintiffs had established a reasonable probability of success that the Board had breached its fiduciary duties by refusing to release Upper Deck from the Standstill Agreement to permit it to undertake the foregoing actions and on their claims that the merger proxy contained material misstatements or omissions.

In reaching this decision, the Delaware Chancery Court made a number of important findings and observations, including that:

(1) Standstill agreements in general can serve legitimate purposes in a sale process by helping a target "ensure that confidential information is not misused by bidders and advisors whose interests are not aligned with the [target], to establish rules of the game that promote an orderly auction, and to give the [target] leverage to extract concessions from the parties who seek to make a bid;"

(2) Standstill agreements in general can be "subject to abuse" by a target that improperly seeks "to favor one bidder over another, not for reasons consistent with stockholder interest but because managers prefer one bidder for their own motives." A target's board "is bound to use its contractual power under [a standstill] only for proper purposes" (such as "extracting reasonable concessions . . . in order to unlock higher value");

(3) Once a board of directors of a target has decided to put the company up for sale, the board cannot rely on pretextual or unsubstantiated reasons to avoid dealing with a credible third party that has made a bona fide bid for the company and it must consider the price and other material terms of that bid compared to those of other bids. By failing to "undertake diligent good faith efforts at bargaining with Upper Deck" and then not releasing Upper Deck from its obligations under the Standstill Agreement so that Upper Deck could pursue to a non-coercive tender offer for shares of Topps common stock at a price higher than that provided for in the Merger Agreement, the Board likely breached its ***Revlon*** duties[3] to "take reasonable measures to ensure that the stockholders receive the highest value reasonably attainable" for the shares;

(4) By not releasing Upper Deck from its obligations under the Standstill Agreement to permit Upper Deck to comment on its negotiations with Topps, the Board acted improperly (although the Court did not specify whether this action breached a fiduciary duty and, if so, which one(s)) because it thereby forced Topps shareholders to "mak[e] an important decision on an uninformed basis." In particular, the Court focused on Upper Deck's inability to refute Topps' public statements (in the merger proxy and elsewhere) that Upper Deck was not serious about acquiring Topps;

(5) The Board's decision not to treat Upper Deck as an Excluded Party was "highly questionable." The Court acknowledged that Topps may have had legitimate concerns about Upper Deck's bid given (a) the "final hour" nature of the bid, (b) Upper Deck motives, as Topps' chief competitor, to use the due diligence review to obtain confidential information about the Company and (c) that Upper

[3] See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1986).

Deck may have been seeking to "blow up Topps' deal with Eisner." However, in light of the "substantially higher price" being offered by Upper Deck, and the fact that granting Upper Deck status as an Excluded Party "would have cost Topps nothing," the Court concluded that failing to do so is difficult to explain on any basis other than an improper preference for the Eisner transaction.

(6) Topps merger proxy was materially misleading for a number of reasons, including the following:

(a) It failed to disclose Eisner's repeated assurances to Shorin and other members of Topps' senior management that they would be retained by Topps after the merger;

(b) It failed to disclose a January 2007 presentation to the Board by Topps' financial advisor that, in the Court's view, "casts doubt on the fairness of the merger." Specifically, the merger proxy failed to disclose this presentation to the Board and to explain the reasons for certain changes -- relating to Topps' costs of capital and exit multiples -- from this presentation to a March 2007 presentation which may have resulted in lower valuations of the Company and thus may have made it easier for the Board to reach the conclusion that Eisner's bid was fair to Topps' shareholders from a financial point of view;

(c) It misleadingly stated that there was a general belief in the marketplace during 2006 that Topps was "willing to entertain acquisition proposals" when, in fact, in July 2006 Shorin had made public statements to the effect that Topps was not for sale;

(d) It failed to disclose that Upper Deck sent an expression of interest regarding a business combination to the Board (through one of the Dissident Directors) before the go shop period began;

(e) It failed to disclose material facts regarding Upper Deck's bid, including that:

(A) It is not subject to a financing contingency;

(B) Upper Deck would be liable for the same reverse termination fee as Eisner if it breached the proposed merger agreement and failed to close the transaction;

(C) Although the commitment letter from the Upper Deck Financing Source contains a number of conditions, many of them are the product of the fact that Topps refused to provide Upper Deck (or even the Upper Deck Financing Source on a confidential basis) with due diligence information; and

(D) (i) It contains a "hell or high water" antitrust provision that requires Upper Deck to divest assets in order to obtain antitrust approval of the transaction, (ii) there is evidence supporting a conclusion that an Upper Deck/Topps business combination would not encounter any antitrust problems, (iii) Topps itself had prevailed in prior antitrust litigation regarding a business combination with another leading baseball card producer and (iv) Upper Deck could not begin the HSR antitrust approval process unless it were granted relief under the Standstill Agreement to commence a tender offer for shares of Topps common stock; and

(f) It failed to disclose that the Standstill Agreement prevented Upper Deck from commencing a tender offer for shares of Topps common stock.

(7) In the context of the transaction, (a) the 40 day go shop period, (b) Eisner's right to match any superior proposal and (c) the amount of the termination fee were all reasonable deal protection mechanisms. In particular, the Court found that (x) a 40 day go shop period was sufficiently long to permit rival bidders to conduct due diligence and submit a competing bid to the Board and (y) the termination fee (approximately 4.3% of the equity value of the transaction) was reasonable in light of the relatively small size of the deal and the fact that it included Eisner's expenses.

(8) Based on the facts, certain aspects of the sale process through the signing of the Merger Agreement were not unreasonable. These included the Board's decision (a) to disband the Ad Hoc Committee, (b) to establish the Executive Committee consisting entirely of Incumbent Directors to consider proposals received during the go shop period (but reserving for the full Board determinations regarding whether any such proposals constituted superior proposals or could reasonably be expected to result in one), (c) not to undertake a pre-signing public auction of the Company, particularly in light of the failed auction of the bubble gum business, and (d) to enter into the merger agreement even though a few days before doing so it had received an indication of interest from Upper Deck regarding the baseball card business. However, the Court did make clear that "[c]ritical [to this] determination" was the Board's recognition "that they had not done a pre-signing market check" and therefore "secured a 40 day [g]o [s]hop [p]eriod with the right to continue discussions with any bidder arising during that time who was deemed by the" Board likely to make a superior proposal.

Lessons For M&A Practitioners

The *__Topps__* decision contains many important lessons for M&A practitioners under Delaware law, including the following:

(1) In certain circumstances, standstill agreements that prohibit a bidder from (a) commenting on the negotiation process to correct misstatements or misleading statements by the target and (b) commencing a non-coercive tender offer at a higher price than that contemplated by an existing merger agreement, may be unenforceable under Delaware law. Accordingly, in negotiating standstill agreements, bidders should consider:

(a) Negotiating for carveouts that permit them to (i) comment on the negotiation process or other matters to the extent necessary to correct material misstatements or omissions by the target or its affiliates or advisors, and (ii) commence a non-coercive tender offer for the target's equity securities at a higher price than that contemplated by an existing merger agreement; and

(b) Whether there are other typical standstill provisions that they may wish to delete or seek carveouts from based on the possible unenforceability of such provisions, including the common provision not to make an offer or proposal to the target regarding a business combination transaction without the target's consent;

(2) Except as noted above, standstill agreements are probably enforceable when used for the legitimate purposes identified by the Delaware Chancery Court and noted above;

(3) In negotiating merger agreements, targets should always insist on the right to release parties that have signed standstill agreements from any provision of the agreement if the failure to do so would or would reasonably be expected to be inconsistent with the fiduciary duties of the target board to the target's shareholders under applicable law;

(4) In determining whether a party has submitted a proposal that constitutes a

superior proposal or a proposal that could reasonably be expected to result in a superior proposal for purposes of determining whether the party is an "excluded party" such that the target board can continue to negotiate with the party after the end of the go shop period (and in most cases pay a lower termination fee if the target elects to terminate an existing merger agreement to enter into a merger agreement with the party), the target board must evaluate the party's proposal in a thorough, objective and impartial manner;

(5) A go shop provision can, under certain circumstances, compensate for the absence of a pre-signing market check and issues regarding the integrity of the sale process;

(6) The Delaware Chancery Court is going to hold merger parties to a high standard with respect to full and fair disclosure regarding the merger negotiation process and the terms and conditions of the merger, particularly with respect to (a) arrangements and understandings (not just agreements) between buyers and members of target's senior management, (b) differences between multiple financial analyses presented to the target's board, particularly when the presentation primarily relied upon by the target's board in approving the transaction makes it easier for the board to conclude that the transaction is fair to the target's shareholders and (c) certain fundamental terms of the deal with the first bidder and those proposed by subsequent bidders, such as terms and conditions relating financing and regulatory approvals; and

(7) The combination of (a) a termination fee and expense reimbursement equal to approximately 4.3% of the equity value of a deal (at least in deals under $500 million) and (b) a right on behalf of the first bidder to match any superior proposals, constitutes reasonable deal protection mechanisms, at least in transactions involving a go shop process. This is among the highest termination fees ever expressly upheld by the Delaware Chancery Court. The Court made it clear, however, that such a high termination fee (in percentage terms) may be appropriate only in relatively small deals where that amount includes expense reimbursement.

Should you have any questions about the matters addressed in this issue of *M&A Notes*, please contact the following Kirkland & Ellis authors or the Kirkland & Ellis partner you normally contact.

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