

KIRKLAND M&A UPDATE

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Some Tender Offer Quirks

In considering a tender offer structure, practitioners should be aware of a number of quirks that have come to light in recent tender offer transactions that may impact or offset the advantages of using this structure.

Much has been written about the advantages of structuring a friendly acquisition as a tender offer followed by a back-end squeeze-out merger as compared to a single-step merger. Some of these perceived benefits include speed to closing, avoiding adverse recommendations from proxy advisory firms such as RiskMetrics (ISS) and mitigating the risk of “empty voting.” With SEC clarifications to the “best price” rules in 2006 and the occurrence of a few all-equity sponsor buyouts, we have seen a significant uptick in tender offer activity in both the private equity (e.g., Apax/Bankrate and Apollo/Parallel Petroleum) and strategic (Bristol Myers/Medarex and J&J/Omrix) spaces. In considering a tender offer structure, practitioners should be aware of a number of quirks that have come to light in recent tender offer transactions that may impact or offset the advantages of using this structure.

The policies and practices of index and quantitative funds with respect to participation in tender offers vary widely. Many such funds will not tender into an offer where the market price is above the offer price. Moreover, many will not tender into an offer at all, regardless of the relationship of the market price to the offer price, so long as the stock is still included in the relevant index the fund is mirroring or tracking. In situations where there is significant holding of the target stock by these funds and reaching the minimum tender condition is a close call, these policies and practices can be determinative of success or failure. In addition, to the extent such fund decisions are in fact affected by market price at the time of the expiration of the tender offer, these practices create an additional opportunity for arbitrageurs interested in the success (or failure) of a tender offer to influence the outcome of the offer by effecting minor price movements above or below an offer price. Finally, even if a tender offer is successful in achieving the minimum condition, the ability of an acquirer to reach the minimum threshold (usually 90 percent) required to effect a short form merger on the back-end (and thereby avoid the expense and delay of a full-blown proxy statement) may be constrained by the behavior of those funds that will not tender under any circumstances while the stock is still in the relevant index.

Separately, in some cases RiskMetrics appears to be abandoning its historical practice of not making recommendations on friendly tender offers. Some recent high profile examples include adverse recommendations in the CVS/Long Drug Stores and Apax/Bankrate tender offers. While it remains unclear how many clients will in fact follow recommendations from proxy advisory firms in friendly tender offers, these opinions could certainly impact target shareholder sentiment and, like the index fund practices, in some cases may be determinative of outcome.

Below are a few suggestions in light of these developments if a tender offer structure is preferred:

- Ensure that any assessment of the target shareholder base includes levels of holdings by index or quantitative funds, particularly in industries or sectors where the target may be included in multiple indices. Given the funds’ investment mandates, these shares are often “sticky” and do not rotate into the hands of arbitrageurs following announcement of the deal.
- Seek early removal of the target from indices thereby freeing the funds to tender. This tactic is likely most useful after a successful completion of the initial tender offer and during a subsequent offering period where the acquirer is seeking to achieve the requisite ownership level for a short-form merger.
- As is usually the case in a one-step merger vote, engage with RiskMetrics and other proxy advisory firms early in the process to determine if they intend to issue a recommendation and seek to influence any such advice. Buyers should consider including in the purchase agreement a requirement that the target cooperates in these efforts.

While in many cases using a tender offer structure offers undeniable advantages, buyers and sellers and their advisers should be aware of the peculiarities described above and others that may develop or come to light as tender offers become more common in the deal landscape.

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